

CHALLENGE

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CHALLENGE

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October 1, 1961

FORESIGHT AND THE FACTS: "The two principal governmental weapons to combat recession and slackness are fiscal (i.e., tax and expenditure) policy and monetary or credit policy. In ordinary times both should be pushed hard so that they are reinforcing rather than conflicting. These are not ordinary times. Until our new programs have taken effect, America does not have the freedom of balance of payments constraints that she enjoyed for the 25 years after 1933."

These words, taken from the then President-elect Kennedy's "Economic Task Force Report" have suffered the usual fate of prophecy.

Concern about the balance of payments has taken a back seat and a solid economic recovery is reported from all sides. The forthcoming rise in defense expenditures makes for an added fillip. The Federal Reserve's Index of Industrial Production reached 113 in August—exceeding the old record of 111 set in January, 1960. Back in February it was down at 102. Many economists are predicting that it will reach 120 by December.

This pickup of economic activity occurred as businessmen began to rebuild inventories and the federal government loosened the purse strings and stepped up expenditures. The budget deficit for fiscal 1962 is expected to be near \$6 billion—which will provide a strong boost to the whole economy.

Let us look at the picture from the consumers' side. Expenditures for durable goods are rising. With savings at a high level and indebtedness for installment payments relatively low, a real boom is possible if they decide to buy in great volume.

The eagle-eyed and ever-cautious Federal Reserve Board is ready, by tightening credit if necessary, to slow down any boom that may develop. Such an application of the brakes is not yet in sight since the economy still has a lot of room to expand before inflationary pressures become dangerous.

Talk of a boom is received with a "show-me" attitude by the unemployed. Close to 7% of the labor force is in this unenviable position, despite record levels of employment. A significant reduction in the rate of joblessness is not likely this year.

Although unemployment tends to prevent inflation, the cost is high in production foregone and human wastage. In the emerging computer technology of today, changes in production methods are responsible for much of the current unemployment.

Inevitably, as the high rate of unemployment persists, pressures to do something about it—for instance, by restricting imports or spreading employment—are likely to mount.

Great economic foresight and political courage will be needed to solve the unemployment problem without making the remedy worse than the disease.

SPECIAL CORRESPONDENCE—The anti-Administration forces in Congress are beginning to get their second wind. After losing the big battle with the President over the expansion of the House Rules Committee and the subsequent passage of the housing, depressed areas and minimum wage bills, the conservative coalition has begun to regroup its forces. The coalition's resurgence became quite evident with the defeat of the aid to education bill, the failure of the tax reform bill to emerge from committee and the final compromise on foreign aid.

This stiffening opposition to the Kennedy program foreshadows more trouble for the New Frontier when the second session of the 87th Congress convenes in January. The anti-Administration forces now believe that they will win the key legislative battle of the next session—the fight against medical care for the aged under social security.

The increasing resistance to the Kennedy program is undoubtedly a reaction to the heavy political pressure many Congressmen have been getting from the White House. In addition, many legislators are convinced that there is a rising tide of conservatism among their constituents. This, of course, is only conjecture. The voters' true feelings will not be known until next year's Congressional elections—which could bring some real surprises.

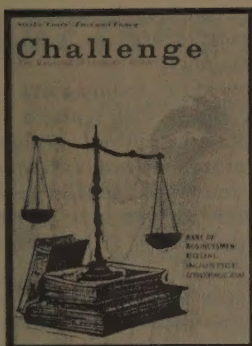
The President is trying to heal the breach in his working relationships with the top leaders of the business community. These relationships became extremely touchy after Mr. Kennedy refused an invitation to address a meeting of the U.S. Chamber of Commerce last spring. They became further aggravated when the Business Advisory Council severed its 28-year-old connection with the Commerce Department.

The President is now encouraging his staff to contact key business leaders for advice on important problems. For example, Kennedy called in the leaders of the National Association of Manufacturers, the U.S. Chamber of Commerce and the Committee for Economic Development to seek their assistance in finding good men to fill top jobs in the foreign aid program. The appointment of George D. Woods, Chairman of the First Boston Corporation, as head of the foreign aid program, came as a result of these consultations.

The President undoubtedly felt that such overtures coupled with the Woods appointment would blunt some of the business community's latent opposition to various aspects of the foreign aid program. Administration political strategists feel that friendlier relations with business might also aid them in putting across other New Frontier proposals when Congress reconvenes in January.

In sharp contrast with Washington's deep concern over the Berlin crisis, our principal Western European Allies are far more concerned with their own internal problems. The British are much more concerned with their stagnating economy and the negotiations to join the Common Market. And the French are far more interested in the future of Algeria and the problem of Bizerte. As for the West Germans, the identity of the next Chancellor seemed to hold more excitement than the fate of their former capital.

The Japanese have greeted the British decision to apply for Common Market membership with great enthusiasm. Tokyo feels that no matter what the final arrangement is in regard to the Commonwealth, Britain's commercial ties with her former colonies will inevitably be weakened. If Commonwealth trade preferences are reduced, the Japanese are particularly anxious to increase their trade with Australia and New Zealand. Japan needs Australian meats, wool and dairy produce. In return, it expects to export textiles, machinery and electronic equipment.



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Challenge

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VOL. 10 NO. 1
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ARTICLES

- Equal Injustice Under Law 6
Absolute criminal liability. By Gerhard O. W. Mueller
- Strike "Costs": Fact and Fancy 9
The impact of labor strife. By Hans Apel
- Europe's American Revolution 13
The mass market and the Old World. By Kenyon E. Poole
- Convenience, Not Status Symbols 17
What the new consumer wants. By Stanley C. Hollander
- What Goes Up Can Come Down 20
Wall Street in Wonderland. By Burton Crane
- Exports—Lifeblood of Japan 29
A CHALLENGE report from the Far East. By Wallace L. Higgins
- A Nationwide Treasure Hunt 32
Financing public needs. By Harvey E. Brazier
- Are the Forecasters Too Optimistic? 36
Projections for 1970. By William C. Freund
- Canada at the Crossroads 39
Nationalism vs. economic cooperation. By William Wolman
- The New Illiterates 42
The basic problem in American education. By Mortimer Smith

INTERVIEW

- Seymour L. Wolfbein 24
Deputy Assistant Secretary of Labor

DEPARTMENTS

- Editorial 4
- Letters to the Editor 5
- Books 45

A LOOK BACK

THE LATE and highly regarded Austrian-born Harvard economist, Joseph Schumpeter (d. 1950), published an highly original work in 1942 entitled *Capitalism, Socialism and Democracy*. This bit of information can hardly be news in 1961, but I would suggest that if (1) you are one of those who has not read the book, and (2) you want to increase your understanding of the dynamics of American capitalism and where they can lead us, then read *Capitalism, Socialism and Democracy*.

"Can capitalism survive?" Schumpeter asks. "No, I don't think so," he answers. Although Schumpeter derives no joy from this conclusion, to my mind he has rendered a greater service to American society today than he might have thought possible. The book shows its age in a number of spots, but the basic issues it deals with are as up-to-date as today's headlines.

With all due respect for the current concern, with unrestrained nuclear testing, the Berlin crisis, turmoil in the Congo and the U.N. debate on Red China, the simple fact is that all these are pawns on a giant chessboard that pits capitalism, our king piece, against communism, the king piece of our opponent. Each side has its complement of supporting pieces (social and political ideals and institutions) that can be used offensively or defensively. But the main idea—now that we are in a game involving undeniably high stakes—is to place the other side's king in check.

Capitalism, Socialism and Democracy, though written outside the context of the cold war, provides us with some extraordinary insights to the pieces on our side of the board—the social and political milieu that, from my point of view, will hold or lose whatever it is that we call American capitalism. Schumpeter's thesis of unexpected strengths in American capitalism—and of unsuspected, self-inflicted weaknesses—does not consider the steps that might be taken to avoid the demise, as he expects, of our economic order. For Schumpeter merely called the shots as he saw them. And what he saw was a gradual decline for American capitalism—not because of its weaknesses, but because of its successes—achieved at the price of considerable deviation from our more formal understanding of how American capitalism is supposed to work.

In other words, Schumpeter saw operational contradictions in 20th-century American capitalism just as Marx saw substantive contradictions in 19th-century European capitalism. The two men, however, were not only a century apart. They were also separated by a vast ideological gulf. Marx disliked capitalism. Schumpeter

was an ardent admirer of the capitalism whose eventual end he regretfully predicted.

This prediction is based on four developments that Schumpeter says will gradually lead us to socialism, quietly and without revolution.

First, Schumpeter points to the declining role of the individual entrepreneur, who is being replaced by the corporate bureaucracy. With the individual's contributions superceded by an institutionalized, social process, the chief distinguishing feature of capitalism is adulterated. And a bureaucracy, whether it be private, or one converted to public ends, can go about its business no matter for whom it works.

Second, Schumpeter concludes that the small capitalist is rapidly becoming extinct in an economic world of giants, and therefore the number of people ideologically attached to capitalism grows ever-smaller.

Third, Schumpeter regrets that under the pressures of mass production and consumption, all other orientations that might have sustained a nonbusiness class of people have withered away, thus leaving only businessmen to govern the state as well. The result is that neither state nor businesses are properly tended.

And, finally, Schumpeter points out that only from the material affluence of our capitalist system could there emerge a host of professional intellectuals whose words of criticism of capitalism, spoken with immunity, can so widely and comfortably be entertained.

I do not concur in Schumpeter's pessimism, but by pointing out the differences between what we call capitalism and what we practice as capitalism, Schumpeter has unintentionally delineated for us exactly what we stand to lose if we should fail in the cold war. It seems to me that what we could lose is still a far sight better than the alternative offered by our opponent. For whatever American capitalism has become, it is still a dynamic and fruitful operation of our own unique and democratically oriented society.

... to find out what we are

We still have the power to say what we want American capitalism to be, and what we don't want it to be. That we need a better understanding of what our economic order really is like I have no doubt. That it is necessary to understand our system in order to win the cold war is just plain good sense. And I point to Schumpeter's work to help us understand what we are.

In effect, Schumpeter says we do not practice today what we started preaching 150 years ago. I say we ought to preach what we practice, once we know what we want from our current practices. Schumpeter can help us to this end, even if he suffers the embarrassment of our not accepting his conclusions. To know what we are is our first defense against a system that we say we would rather be dead than accept.—H. B.

LETTERS TO THE EDITOR

CHALLENGE invites your comments. Address letters to
CHALLENGE, 475 Fifth Avenue, New York 17, N. Y.

CODES FOR CONSULTANTS

• I enjoyed reading L. H. Naum's article, "Business on the Couch," [April, 1961]. The only criticisms I have of it are that I do not feel it is true that "few of the various branches of professional consulting have established any code of behavior and standard of practice." As a matter of fact, most of these groups do have well-conceived codes of ethics and professional practices today.

Second, consultants are *not* frequently hired to support a difficult or unpopular management decision. Few, if any, reputable consultants will take this kind of assignment.

Third, although a formal discipline or common body of knowledge is still the weakest link in the claim to professional status, consultants are spending a good deal of time in defining this body of knowledge they must possess and share in common.

PHILIP W. SHAY
Executive Director,
Association of Consulting
Management Engineers, Inc.

New York, N.Y.

NEED FOR INVESTMENT

• I certainly concur with the conclusions of Dr. Sergei Dobrovolsky in "Can We Get More for Less?" [July, 1961]. I am afraid that too few people understand the real magnitude of our requirements for new capital facilities today. It will take a tremendous investment in new facilities to enable the U.S. to compete both economically and militarily.

This article is certainly timely and should be read by every American citizen. Unfortunately, learned evaluations of this nature seldom appeal to the man in the street or the editors who determine the public literary diet.

JAMES C. KELLEY
Executive Vice-President
American Machine Tool
Distributors Association

Washington, D.C.

COMPLIMENT

• This is just a note to compliment you on CHALLENGE. In the July issue, for example, I found the Benedict, Roskamp, Silk and Dobrovolsky articles

of particular interest. And, needless to say, I was pleased about the article by our Council staff member, Robert C. Colwell.

WALTER W. HELLER
Chairman, Council of
Economic Advisers

Washington, D.C.

RESEARCH AND DEVELOPMENT

• Prof. Daniel Hamberg ["Less Noise, More Research," May, 1961] admits that even the experts don't know where basic research ends and applied research begins. Yet he goes on blithely to state that the big emphasis in the United States is on applied research and not on basic research.

According to him, the alternatives are black and white. However, in reality, the alternatives are not quite so simple. Frequently the alternatives may be either good applied research or lousy basic research. This helps explain the reluctance of industry to invest large sums in basic research where it is relatively easy to consume funds for years and not have any results to show.

Considerable development and planning are needed before a new product is placed at the disposal of the public. Frequently, careful study and observation must be carried out in order to ascertain that the new product is not a cause of serious harm to the user. Moreover, many a good and valuable product, invention, discovery and service has long been forgotten because of poor development which inadequately placed before the public its merits and/or availability.

Obviously, Prof. Hamberg assumed that insufficient funds are being spent on basic research and then attempted to verify his previously accepted conclusion.

HUGH W. GOURLEY

Chicago, Ill.

FOREIGN AID

• David Secunda of the American Management Association has some interesting ideas about foreign aid [Interview, July, 1961]. For example: "The businessman has a moral obligation to ask himself some questions about where and how far we can go with foreign

assistance programs." Later on he says, "Perhaps we are not very good strategists. Maybe we ought to let them [the Soviets] dig into the economic bone a little."

I presume Mr. Secunda means that we ought to let the Russians bleed their economy to help underdeveloped countries while we contemplate our "moral obligation" to ourselves. What a farsighted approach to the problems of the world today! How such words must charm the uncommitted nations! I fervently hope that Mr. Secunda's viewpoint does not represent that of American businessmen in general.

MARILYN DAVIES

Cambridge, Mass.

ON FREE ENTERPRISE

• "Lessons from the West German Miracle" by Karl W. Roskamp [July, 1961] was the most informative and interesting account of West Germany's postwar economic record that I have read.

I was surprised to learn the extent to which the government, by using monetary and fiscal policy, was responsible for West Germany's remarkable economic progress. It is certainly revealing to note that "about 56 per cent of all net investment between 1948 and 1957 was influenced in one way or another by public preference." Obviously, as Prof. Roskamp says, the West Germans "were quick to recognize that there are many situations in which the free market forces must be aided and guided in order to facilitate structural adjustments and to generate a satisfactory rate of economic growth."

We can see from the West German experience that a certain amount of central guidance and planning is not incompatible with a free enterprise system. I believe that planning might be thought of as the grease which allows the wheels of free enterprise to turn more smoothly and effectively.

PAUL ARONDSSEN

St. Paul, Minn.

LABOR AND FREE TRADE

• Philip Taft's article ["Erosion of an Ideal," July, 1961] was an eye-opener. How can labor organizations possibly support protectionist policies in the face of the realities of world trade today? If labor leaders try to dig themselves in behind a wall of tariffs without considering the needs of the U.S. and other free world countries for expanded international trade, they will find that they are digging their own graves.

JEAN BEAUPRE

New Orleans, La.

EQUAL INJUSTICE UNDER LAW

by GERHARD O. W. MUELLER

► *Most citizens and practically every businessman could wind up behind bars if all the laws and regulations on the books were rigidly enforced. Loosely drawn statutes and capricious administration make a businessman especially liable to fines and even imprisonment despite his efforts to be law abiding. The author, Professor of Law at New York University and Director of its Comparative Criminal Law Project, proposes a program to correct these abuses which have no place in a society professing to believe that a man is innocent until proved guilty.*

DID YOU EVER have a nightmare in which a prosecutor distortingly accused you of a heinous crime? The court was ready to convict; yet your tongue was of lead and you could not utter the answer which would refute the charge!

With increasing intensity, American business has become the victim of such nightmares—only, the nightmares are real and they happen in broad daylight. This nightmare is *absolute criminal liability*.

Suppose a truckdriver, who had loaded his vehicle at 15,200 lbs., attested to by a certificate from a state-licensed weigh master, is stopped on the turnpike by state troopers with portable scales. This time the truck weighs in at 16,015 lbs., 265 lbs. above the legal limit. The truck driver is immediately arrested and hauled before a judge. "Trial" may take place immediately.

The police sergeant states his case: "This fellow drove a truck weighing in at 265 lbs. above the maximum limit. He therefore violated the State Penal Code Sec. 19-8-4." The judge responds: "I find you guilty."

"Wait a minute, your honor," the truck driver will reply. "I've got this

here weight certificate from the state-licensed weigh master."

"Quiet, I'm not interested in that," the court thunders.

"But Judge, the truck weighed in at 15,200, it says so right here!"

"One more word and I will find you guilty of contempt and have you jailed," is the answer. "This is the law of the state: it says you must not drive a truck weighing more than the limit permits. You did. You are guilty. There are no excuses of any sort. The fine will be \$150."

It might have been \$25 or \$1,000 or even three days in jail as an alternative. For those whom ill fortune strikes twice, jailing is usually mandatory. And the employer of the helpless truck driver may be subject to additional fines. The firm suffers the humiliation of a criminal conviction and its sales are likely to drop off.

This is not a description of a kangaroo court in Cuba or in the Congo. This is America, 1961. A railroad can be found guilty of the crime of transporting whiskey on which tax has not been paid, if a shipper ships such contraband in an innocuous-looking box. A supermarket can be found guilty of short-weight selling if any one of 10,000 sales clerks makes a short-weight sale, intentionally or accidentally. An employer can be guilty of the crime of employing a minor because a foreman hired a husky youth who exhibited his brother's driver's license.

In short, no matter what economic activity you are engaged in today, you are regulated by a penal law which might punish you without the slightest fault on your part. Absolute criminal liability hangs over your head.

Every echelon of government—

local, state and national—is putting this startling psychology to use: punishment of the guilty and the innocent alike. Among the federal laws such important statutes as the Federal Communications Act, the Food and Drug Act, the Interstate Commerce Act, the Emergency Price Control Act, the Eight Hour Law and the all-pervading False Claims Act impose absolute criminal liability. Thus, everyone who in any communication with his federal government makes an objectively false statement—whether known to be false or not, whether made despite careful inquiry or not—can be punished.

Under the traditional American rule of law, when a citizen charged with a crime appears at court he is presumed innocent until proved guilty beyond a reasonable doubt. Or at least the court will permit him to tell his side of the story and give him a chance to rebut the presumption of criminal wrongdoing which arises from the proof that his act produced a prohibited result.

FOR MURDERERS, rapists, robbers and their ilk, this traditional standard of civilized court proceedings still prevails. But when a businessman or corporation is charged with a criminal offense in the "regulatory" sphere, the law is now commonly otherwise. Gone is the presumption of innocence, gone is the chance to prove one's good faith. Instead, the doctrine of absolute criminal liability rules.

In this context I do not propose to discuss the merits or demerits of the many regulatory agencies, or of the myriad regulatory laws. What is important to note, however, is (a) the dragnet nature of practically all of these statutes ("restraint of trade," "suitable fire escape," "food and ne-

cessities") and (b) the enormous discretion, especially of selective enforcement, vested in prosecutors and agencies.

NO RELIABLE STANDARD exists, this implies, for the business world to abide by. It also means that, unless a given entrepreneur wants to incur the wrath of an administrator and risk being punished for innocent violations, he must abide by the paternalistic and bureaucratic notions of the administrative agency. In view of the utter uncertainty of the standards of these agencies, the imposition of absolute liability, through removal of the requirement of criminal intent (guilt), is doubly vicious.

Even those who favor absolute criminal liability readily concede that if administrative discretion as to whom to prosecute were not exercised, millions of citizens would wind up behind bars and the system would break down. Thus, the Department of Justice and other enforcement agencies try to select for prosecution only the "hard core per se" violations. But what is a "hard core per se" violation?

Prior to the recent startling conviction of electrical companies, the antitrust laws have led to the jailing of only a handful of businessmen. Perhaps that speaks well for the government's selective policy. Perhaps the government did succeed in identifying the hard core per se cases—though there is plenty of evidence that, in certain convictions, only Heaven and the administrative agency knew why a prosecution was initiated in the first place.

But all this is beside the point. What matters is the aimlessness and uncertainty inherent in our system of regulatory laws: they fail to effectively guide future conduct, because they fail to employ the criterion of criminal intent to clearly differentiate beforehand between what is desirable and lawful conduct, and what is undesirable and unlawful conduct.

The most subtle, yet most vicious, application of absolute liability is in situations where the perpetrator, despite diligent inquiry, could not know that his conduct was in violation of the law. Suppose that a businessman does exercise due care—by

acting only on the advice of counsel. But counsel may be wrong. (After all, every case is lost by at least one or usually two attorneys!) In fact, not even counsel may be able to ascertain the proper standard, due to the enormous vagueness of the statutes. The antitrust laws may provide an example.

After the conviction of Liggett & Myers in the American Tobacco case, counsel for the company asked the court: "How does the court want my company to change its behavior from what it has been in the past? What should we do in the future that we are not doing now, or that we have done in the past?" The court did not know.

Now, the antitrust laws, at least theoretically, do require a criminal intent. In these cases the "criminal intent" is at best the intention to promote the profit policy of the company, coupled with the fear that the Justice Department *may* dislike the vigor of that policy. One commentator recently explained the "monopolistic intent" of the Sherman Act as



"one of those things of which people say: 'I can't really define it but I know it when I see it.'" And Chief Justice White called it something other than the "normal methods of industrial development." What helpful definitions! What helpful standards to guide businessmen in the conduct of their affairs!

There is practically no instance of absolute criminal liability in our law prior to 1850. Coolly and calmly the judges implemented the well-known principle of stimulus and

response—i.e., that if you want people to behave in a certain way, you must find the most suitable stimulus to obtain the desired response. Pain and pleasure, or punishment and reward (or at least impunity) were the stimuli. Those who violated the well-known rules of the social game by committing crimes were punished, as were those who produced proven criminal harm by reckless conduct. But those who chose the path of lawfulness, or who operated with the expected care and circumspection, were rewarded by impunity.

Surely nothing has changed as far as the stimulus and response, and the pain and pleasure principles are concerned. Far from overthrowing such natural laws, the good Doctor Freud built his psychoanalytic theory right on top of them.

THIS NEW PHILOSOPHY OF LAW removed the guilt element from a major segment of penal legislation. It was a revolutionary doctrine that was accomplished with very little rationalization beyond vague claims of the greater effectiveness of laws which permit no excuses. Extensive rationalizations were fabricated only after the pernicious practice was well established and, as if from broken records, the arguments still resound from lecture halls and court rooms. Here are some examples:

- Absolute criminal liability makes criminal convictions possible where there could be none if criminal intent were required. (I concede the point. But are we interested in convicting everybody? We should convict only wrongdoers, not those whose wrongdoing is in doubt.)

- Criminal intent would be hard to prove in regulatory offenses. (Criminal intent is even harder to prove in some traditional crimes, yet nobody would propose to dispense with criminal intent in rape charges.)

- The requirement of criminal intent would lead to fabricated defenses. (The danger is even greater in capital crimes, where the temptation to fabricate defenses is much more acute. But repeal of criminal intent in homicide would land the state's executioner in the electric chair.)

- The occasional conviction of an innocent citizen is a price we have to pay for more effective regulation.

The punishments are but slight. Hence, it does not matter too much. (It seems to me that any attempt to discriminate between little and big injustices, and to suffer little injustices, would be to degrade the moral standard of human beings to the level of sewer rats. Besides, while the \$100 fine or 30-day jail sentence for an innocent businessman may be but a minor inconvenience, the stigma of criminality lasts a lifetime, and his business just might be adversely affected thereby!)

- The ultimate argument is always that absolute liability has a deterrent effect greater than the liability based on conscious wrongdoing. This point requires careful analysis.

First of all, due to the enormous sweep of absolute liability laws, it is impossible to investigate or even prosecute all violations. At most 10 per cent of all technical violations do become apparent; at most 50 per cent of those are investigated; at most 10 per cent of those result in charges, and at most 50 per cent of those result in convictions. Obviously these are very rough (and probably much too conservative) estimates. But if I am right, only one in 400 (perhaps it is one in 4,000) of such violations results in a criminal conviction. In contrast, 93.5 per cent of all known murder cases are cleared up by the authorities; yet people still take a chance at murder. Now what about the deterrent effect of absolute liability in regulatory penal law?

The deterrent argument is a cliché filled with the grossest analytical flaws. How do businessmen really behave in the face of a possible criminal liability? Can they purchase insurance? No, one may not insure oneself against one's own crimes. Of course, there is a type of "insurance"—usually called bribery—which occasionally has been purchased by frustrated businessmen. Many national and local scandals involving regulatory agencies have acquainted us with this kind of "insurance."

ABUSES ARE inherent in a system under which the power to subject a perpetrator to criminal liability rests almost exclusively in a discretion-invested officialdom, rather than on

the specific statutes of the law.

This system of vagueness and discretion is contrary to the American ideal which posits that ours is a government of law rather than of men—meaning the whim of men who have the power to initiate penal proceedings at will, or to dispense impunity as an act of sovereign grace. Impunity of the innocent cannot be made an act of administrative grace; it is something to which the innocent should be entitled as a matter of law and right.

The psychological effect of unpredictable criminal convictions, resting on no personal conscious wrongdoing, is bound to be severe. The result is, inevitably, a loss of respect for the law.

The worst aspect of absolute crim-



inal liability is the discovery, on the part of the regulators, that those regulated are like a great big wonderful herd of Guernseys. You can milk them and milk them, and they will hardly say moo. I can certainly not be far off in estimating that the cost of running many regulatory agencies, especially on the local and state level, is borne entirely by the fines collected in the process of regulating.

Suppose there is a businessman who has scruples about playing the game in accordance with the "rules" of his particular trade—i.e., either bribery of the inspector or possible criminal liability without fault. After all, not everybody likes racketeering or a criminal conviction for unavoidable conduct. Well, it has been

suggested he can always get out of that business. If he wants to stay in that business, he must accept the risk of being innocently punished.

The argument is so obviously un-American that I should not respond to it if it were not constantly pressed with vigor. Nobody engaged in a lawful business should be forced to run the risk of being stamped a criminal. Quite apart from that, should our entrepreneur sell out and invest in some other type of business he is apt to run the same risk there.

MOST RECENTLY the book dealers were particularly hard-hit. Luckily, at this point, the Supreme Court stepped in and in *Smith v. California* outlawed a Los Angeles criminal ordinance which imposed absolute liability on a bookseller for the possession of any obscene book in his shop. The only way to avoid liability under this ordinance would have been to get out of business entirely, or to restrict the sale of books to those which the dealer could read or inspect.

Said the Court: "If the contents of bookshops and periodical stands were restricted to materials on which the proprietors had made an inspection, they might be depleted indeed." And this, then, would surely impede the Constitutional guarantee of the freedom of the press.

Unfortunately, the Court also suggested that there is an important difference between what feeds the brain and what feeds the stomach. In short, the book-publishing business enjoys under the First Amendment a greater protection than any other lawful business under the due process clause of the 14th Amendment. This is a rather unfortunate conclusion, but probably not the Court's final word.

As a matter of fact, *Smith v. California* is but the latest of a series of cases which has cut deeply into absolute liability. In 1950 the Court barred the expansion of absolute liability into the sphere of major criminality; in 1957 it even recognized ignorance of law as a legitimate defense in a case where a defendant was accused of violating a regulatory ordinance of which he couldn't possibly have been aware.

Unfortunately, not all is well as yet. Regulatory legislation continues

to burgeon, and the cliché of a *tough* law (with absolute liability) is easily sold to legislative simpletons. Movements are afoot to remove the guilt requirement from some economic penal laws which still do require some form of criminal intent—e.g., the antitrust laws. Moreover, since most absolute liability laws have not succeeded in preventing the outlawed conduct, the legislatures are likely to increase the fines—as already has happened here and there—in vain expectation of greater effectiveness or to produce greater revenues. And many courts and vociferous lawyers still practice and preach absolute criminal liability as if it were the cure-all of our national economic woes.

Although the business world could bring considerable pressure to swiftly free itself of a legal rule which wreaks havoc and injustice, there is as yet no organized resistance—as tounding as it may seem. As a matter of fact, with all the millions spent on research, not a single study on the economic effect of absolute criminal liability has been undertaken.

REFORM of the situation calls, to begin with, for a careful review of the existing statutory structure, with the following program in mind:

- The possible repeal of many of the regulatory or public welfare statutes. Many such laws were lobbied through legislatures by competing interest groups for the sole purpose of harassing those regulated—by increasing their risks, dangers and expenses; others were passed solely for fiscal reasons. Even where the laws have no such sinister background, a paternalistic government occasionally overlooks the fact that, on the whole, “natural” laws such as those of supply and demand, and of stimulus and response, take care of the matter rather nicely.

- The possibility of taking care of the enforcement problem through civil laws. Are the heavy guns of the criminal law called for? Or could civil laws do the work less drastically, yet just as effectively, or even more so?

- If a criminal statute is called for, definite standards of criminal guilt or intent should be established. This would separate accidental wrongdoing from intentional or

reckless wrongdoing. Such laws should not operate with absolute liability, for this would frustrate the purpose of effective regulation of conduct. That a violation was unintentional must be a sufficient defense, and that includes ignorance as to the scope of the law. For no amount of ingenuity can remove all uncertainties from language, and no amount of foresight can cover every conceivable case.

If the need for such a law is established, appropriate stimuli to induce compliance should be provided—be these imprisonment, fine, or revocation of license or charter.

Such stimuli are likely to be highly successful when applied to businessmen—men who are trained to make calculated decisions and act only after weighing the consequences. In no other field of human

endeavor is there a greater likelihood of success for the criminal law. My warning, however, is directed against an abuse and overuse of the criminal sanction.

I am opposed to making the businessman the object of indiscriminate government bilking under the guise of fines. I am opposed to withholding from citizens and corporations charged with an economic or regulatory violation the privileges and immunities we grant to derelicts charged with rape. In short, I am simply against a bad legal policy which makes it unduly difficult to be law abiding. You might even say that I am appalled by those who extol to all the world the virtues of our common law, as long as we have not succeeded in overcoming injustice, inefficiency and indifference within our own borders. ■

The Impact of labor strife

Strike ‘Costs’: Fact and Fancy

by HANS APEL

► *What does a steel strike or an auto strike really cost? In many cases nothing, according to HANS APEL, Professor Emeritus of Economics at the University of Bridgeport. In fact, a big strike can actually add to the national output over an extended period. The author, who analyzes both the financial and human aspects of work stoppages, feels that the strike is an obsolete weapon for settling disputes.*

AS THIS ARTICLE went to press, the threat of a nationwide automobile strike seemed to have lifted. If a prolonged strike had taken place, journalists would certainly have pressed the panic button. And as the crisis would have involved some half-million highly-paid workers and one of our most profitable industries, estimates of its “costs” would certainly have been high.

Yet, they might well have been gross underestimates, had the strike

slowed down the strong recovery that is underway. This possibility points up the huge gap that may exist between *direct* and *indirect* losses.

It is simple to estimate the direct losses of a strike in wages and profits foregone. But it is far harder to appraise the effects of a big strike on the whole economy. Moreover, such words as “losses” or “costs” are ambiguous. They may mean, abstractly, a sum of dollars lost. Or they may mean, more realistically, the loss of the things—from beefsteaks to Cadillacs—that these dollars might have bought.

“Costs” can also mean the physical and emotional burdens that strikes generally inflict on the strikers themselves, sometimes also on management, and all too often on many innocent bystanders as well.

Let us first focus on the dollar value of strike costs. Viewed in perspective, they are small indeed. All-time peaks were set in the two im-

mediate postwar years of 1919 and 1945, when wholesale adjustments of war-born inequities were to be expected; in each year about one and a half per cent of actual, total working time was lost through strikes. In no other year was even half that rate reached. Over the last three decades the average was a mere one-third of one per cent. In absolute terms, to be sure, this is close to \$2 billion a year today. But if this sum is big, it is far from catastrophic.

But is the time really "lost"? What would have been "lost" if the automobile production lines had been shut down during, say, a four-week strike? The dealers had plenty of cars and their stocks would have been fully replenished within two or three months after the end of the strike.

RATHER THAN speculating on what a prolonged automobile strike in 1961 might have cost and how it would have affected our economy indirectly, let us consider in detail the results of the last great strike. What happened when the steel industry came to an almost complete standstill for 117 days, from July 15 to November 7, 1959?

The date on which the old steel contract would expire was well known in advance, as was the fact that both sides were preparing for a major struggle. Consequently, the economy began to take appropriate defense measures as early as the beginning of the year. From January to July, steel inventories were rapidly built up, a process which invigorated the entire economy. During this "lay-in" period, steel output jumped from 74 per cent of capacity—a level it had maintained since September, 1958—to over 90 per cent.

When the strike hit, production naturally dropped to a mere trickle. But as soon as the walkout ended, output leaped ahead, soon reaching 100 per cent of 1958's capacity; and it stayed at that level until March, 1960. In other words, much of the output that seemed to be "lost" during the strike was actually produced before it hit and the rest was, perhaps, produced after the dispute ended.

Actually, one can be much more precise. Early in 1959 steel inventories were about 12 million tons; during the "lay-in" period another

16 million tons were added. In the "shut-off" period of the strike, a drain of 23 million tons emptied most of the reserve, but another 15 million tons were added in the "catch-up" period that followed. This left, in all, an *excess* of eight million tons over the strike drain, and, as its necessary result, an equivalent gain in hours worked, wages taken home and profits made during the 15-month period.

But the economy made other gains as a result of the strike. In anticipation of the walkout, steel output started to soar and to boost the entire economy early in 1959; this was mistakenly hailed as a sign of the impending "soaring Sixties." It is now pretty clear that demand for steel was thus kept well above what otherwise would have been "normal."

And top steel production in the "catch-up" period provided a second



strong lift for the economy throughout the first half of 1960.

In view of the recession that followed, evidently the economy, without the stimulus of the strike, might have continued at a moderately upward pace from early 1959 to the present point of recovery.

It would have moved from a GNP of roughly \$411 billion to the present \$445 billion (expressed in constant 1954 dollars)—a quarterly average of \$428 billion at projected annual rates.

Actually, the economy was pushed by the "lay-in" period to a level of \$434 billion and to a peak of \$444 billion in the "catch-up" period—an average of \$433 billion.

As the difference in annual GNP between the two courses is \$5 billion, it appears that over a two-and-one-half-year period our economy

gained about \$12.5 billion as a result of the steel strike.

That is one answer to the question, "How much did the steel strike cost?"

But, of course, the picture has another, less agreeable, side. The "economy" gained, but the "economy" is an abstraction; the gains for the whole notwithstanding, there were sizable losses to some groups, gains to others, and all this over a wider range than might be expected.

Consider, first, the 305,000 "core" steelworkers in the major steel centers (those who had regular employment before the "lay-in" period). They earned, on the average, \$1,600 less between January, 1959 and May, 1960 than they would have if steel output had remained at the 74 per cent level of late 1958; in round figures, they lost about \$100 a month. Another 35,000, "core" steelworkers were employed in New York State where they received limited unemployment compensation. These workers suffered slightly less than the others—each of them lost an average of \$1,450.

Next there were some 85,000 laid-off miners and railroad workers who lost about \$950 each. Then there were 105,000 automobile workers, idled for only about half the strike period, who forfeited roughly \$350 apiece. (The losses of the miners and the railroad and auto workers were cut by unemployment insurance and union benefits.)

For all the four groups—steel, railroad and auto workers, plus miners—the loss averaged \$1,200 per worker, which is about \$75 a month for well over half a million workers.

BUT, there were winners as well as losers in the ranks of labor. Some 125,000 "core" steelworkers kept their jobs during the strike, put in a good deal of overtime and gained \$400 over their normal wage. This figure was far exceeded by 90,000 re-employed workers, who were drawn back to industry from unemployment during the "lay-in" and "catch-up" periods; they benefited by an average of \$2,100 each—not to speak of the psychological gains of regular employment.

On balance, there were 530,000 losers against 215,000 winners, \$650 million lost in wages on one side and

\$240 million gained on the other. Thus, the over-all net loss to labor was slightly over \$400 million.

Of course, there were business losses as well. Profits declined during this 15-month period in the steel, railroad, mining and automobile industries. Their published statements are, however, likely to overstate actual losses considerably. These statements show a drop of over \$1 billion in profits for the strike period. But if their earnings for the last quarter of 1958 are used as a yardstick to measure what earnings might have been had the strike not occurred, the steel industry lost, at most, about \$200 million. Using the same yardstick, the automobile industry gained about half that amount.

In all the sectors of the economy, reduction in total profits because of the strike probably did not exceed \$300 million. This sum was only a small fraction of what was added to the profits of those sectors that benefited from general uplift induced by the strike.

In all, these figures are about as good estimates as can be made from the statistics. And we can now compare fact with fancy—that is, with dogmatic appraisals, easy generalizations and the frequently inspired, though not necessarily enlightened, *pronunciamentos* of amateur economists.

Toward the end of the steel strike, the air waves and the press were humming with inflated estimates of strike costs. Typically, one of our largest weeklies set the over-all cost at close to \$5 billion. We have seen that a considerable *gain*, probably as much as \$12 billion, is a good deal closer to the facts. Wage losses, assumed to average \$2,000, were charted at \$1.75 billion. Our estimate showed great variations and a total loss of \$400 million, less than a quarter of the magazine's figure.

The periodical's estimate of business losses was \$1.5 billion; actually, corporate profits were \$4 billion more in strike-affected 1959 than in 1960. And the assumption that the government lost \$1.6 billion is equally untenable. Just the opposite: a \$12 billion gain for the whole economy must have meant about \$3 billion more in taxes. Obviously, the gap between fact and fancy could hardly have been much greater.

We must be careful not to stumble into one fallacy while getting away from another. It would be an extreme fallacy to conclude from what has been said that strikes are proper instruments for giving the economy a lift—or, for that matter, that the results of the steel strike should be considered as typical. Quite the contrary; its outcome was highly unusual, thanks to a combination of exceptional circumstances.

The impact of any specific strike, and thus its "cost," is largely circumscribed by four sets of general conditions. First in importance is the *presence or absence of any "slack" in the economy*. During boom times or a major war, the economy works at its peak practically around the clock; thus lost output cannot be made up either in advance or afterward. On the other hand, strike "costs" are at a minimum during a recession; for

Third in importance is *the duration of a strike*. A few days will be enough to bring severe shortages if perishable goods are involved. But the supply in warehouses and retail outlets of nonperishable goods—frozen, canned, dried and other processed food, all our clothing, "hard" goods (such as refrigerators) and most of the wherewithal of our daily life—covers, on the average, our needs for 40 to 60 days; but, of late, strikes, on the average, last only 20 days. With regard to all these goods it takes, therefore, an exceptionally long strike to affect final buying and to produce real shortages.

Finally, the *geographic area* affected by a strike is important. During a local or regional strike, buyers can often turn to other sources; therefore output lost in one place is recouped in another. Naturally, industry-wide strikes are different.



supplies are ample and production can be increased at short notice. The big steel strike well illustrates the importance of "slack"; just think of the catastrophic and irremediable effect that a strike of its dimensions would have had in the middle of World War III!

Next in importance comes what may be termed "*perishability of demand*." This term sounds a good deal more complicated than the rather simple fact it stands for. Some goods or services cannot be stored up for consumption, and consumption cannot wait for them; as a result, this demand will just perish. The heat, light and transportation needed today cannot be recovered tomorrow or provided in advance. Substitutes may, however, serve to a limited degree—candles for electric lights, packaged cereals for bread and merrily ticking meters in taxicabs during a bus strike.

However, they invite anticipatory buying, as when the steel strike was impending; for the dates that such major contracts will expire are well known. Thus, to a certain extent, the big strikes are self-cushioning.

THESE FACTORS do much to make strikes far less serious than is so often implied. Rather, society has evolved its own inner defense against them; we might almost set up a law that "*whenever and wherever strikes would hurt us most severely, they are either rare or mild.*" Thus, in wartime, strikes are sharply curtailed by patriotism or law. In times of high prosperity—that is, when both sides have most to lose—strikes tend to be settled quickly; though this is all too often at the consumer's cost. But they are most severe (and they provoke the gloomiest and most strident predictions of their crippling effect on the economy) when

production is slack: that is, precisely at the time when it is easiest to reduce or recoup their "costs."

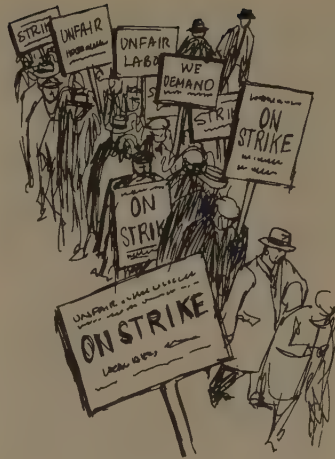
Even the longest and bitterest strikes have seemed to have a built-in brake that stops them "just in the nick of time" and averts disaster. Every day such a strike continues, the combined forces of public opinion, official pressure and actual personal hardships mount; these pressures ultimately convince both sides to settle the conflict.

To sum up the question of the dollar costs of strikes:

- In war, or where vital services are concerned, dollar statistics will, as a rule, greatly understate the real impact of a strike.
 - In normal times, however, when the economy runs considerably below its full capacity, statistics on the immediate effects of strikes will greatly overstate their final impact.
- The strike bill of an average year that may, in the statistics, show up as a loss of about \$2 billion may dwindle, in fact, to a third or a fourth of that sum. And it may be that the normal strike losses of a quarter century are about the same as the economic losses experienced in one year of recession.

THUS FAR, we have reckoned strike "costs"—with rather encouraging results—in terms of goods and money. But there are other costs which are measured in individual suffering. The personal hardships of any long-drawn strike—the gnawing worry, the mounting bills, the desperate hanging on from day to day—these impose a "cost" that cannot be recouped later or offset against inventory as lost production can; they cannot even be measured with any accuracy.

In an average year, there will be more than 4,000 strikes involving at least three million workers. There will be at least as many serious strike threats, averted only by last-minute agreements. Eight or nine thousand flare-ups of distrust each year; then heated conferences, weeks of wrangling, harsh words, passionate tensions and an ugly residue of ill will lingering on for weeks after the strike has been settled or averted. In the factories, roughly eight million workers are occupied for several weeks with the prospect of trouble



to the detriment of their work. In nine cases out of 10, factional strife appears within the ranks of labor itself—resulting in hot arguments, bruised feelings, sometimes bruised skins as well.

At home, the workers' wives are gloomily anticipating weeks without normal paychecks, weeks of privation; the men are torn between loyalty to family and loyalty to the union. In a home dominated by worry, the children inevitably suffer. Inevitably, too, the psychic tensions lead to sporadic outbursts of physical violence. Thirty million man-days of involuntary idleness are bound to produce an abundant share of mischief.

So much for the strikers. But what about the struck? The anguish of corporate executives can perhaps be overlooked; they are well paid for it, although a good many of them might prefer less pay and fewer ulcers. But many strikes affect relatively small businesses. A strike may well jeopardize the economic survival of such an enterprise. For its owner-torturing thoughts of impending bankruptcy may be even harder to endure than the belt-tightening ordeal of the worker. Every normal year there are probably dozens, and possibly hundreds, of real tragedies in the management side of the battle lines.

And what happens to the innocent bystander? Many of the brief strikes which occur here and there during a year may leave him relatively un-

scathed. But there can sometimes be an utterly irrational discrepancy between what is at stake in a strike itself and the degree of public harassment which it produces.

The New York tugboat strike of last winter was particularly hard on the public at large. This strike snowballed until railroad commuter service to the city halted completely. In this case there was, on the one hand, the understandable concern of a few score of people about the future of their jobs; on the other, there was the acute discomfort of over 100,000 commuters. If one reflects for a moment upon the harassment of these travelers—their acute discomfort in the bitter January chill, the hours lost in uncertainty and tiresome waiting—he sees the scales utterly unbalanced and the burden of the strike most unjustly thrown upon those who were not parties to it at all.

NO DOUBT, strikes were necessary from the beginning of the labor movement until a few decades ago. They were necessary because they were labor's only effective weapon against cruel exploitation. They alone made the slogans of "freedom of contract" and "equality of opportunity" something more to the working man than pretty phrases. Through most of this period, business enterprises were steadily growing in size and power; labor had only one choice—combine or knuckle under. In such circumstances not only were strikes necessary, they were also reasonable weapons. This was so even from the point of view of society at large, since the contending parties rarely inflicted significant injuries on the outsider.

But today we are living in a society in which a few hundred striking elevator operators may force tens of thousands to risk coronary attacks while scaling stairs; a score of people, refusing to throw switches in an electric power plant, can plunge a city into darkness, promote a rogue's holiday of major crime and stay the hand of the surgeon from the life-saving operation. Such a world requires something better for the settlement of its labor disputes than the strike, the lockout and the picket line. The strike weapon has become obsolete and must be replaced by

something better—something called reason.

We have been moving in that direction. Techniques of conciliation and mediation have been used and refined through the last three decades. But all too often they have failed. True, *voluntary* arbitration (in which the parties to a dispute bind themselves contractually to abide by the decision of an arbitrator chosen by mutual consent) works well once the parties have agreed on the arbitrators. Unfortunately, however, this method is the exception.

Compulsory arbitration, which might seem the next logical step, has no standing in this country. It has been considered a violation of the

principle of freedom of contract—a freedom strongly endorsed by both management and union leaders. There is, perhaps, more rationalization behind this stand than seems to be assumed in public discussions of the issue, since compulsory arbitration would cut into important vested interests.

Apart from the principle involved, there is the much more practical—and probably justified—fear that a publicly appointed arbitrator would rarely turn out to be the high-principled, well-informed and fully impartial judge whom both sides could trust without reservation. Rather, one must suspect that outside pressures and the prevailing political winds would be reflected in his de-

cisions. With new effort and wisdom, however, these faults could be avoided. However, there is no reason why arbitration courts could not reach the level we now demand from our judiciary. Indeed, there has been some speculation that the newly established Presidential Advisory Committee on Labor-Management Policy may lead us in that direction.

All this reveals clearly our conviction that the strike weapon is obsolete in today's society. But, in spite of our attempts and good intentions, we have not yet succeeded in finding a substitute. Obviously, we must try harder, keep our minds open and remain alert to both the new challenges and new possibilities of our age. ■

The mass market and the Old World

EUROPE'S AMERICAN REVOLUTION

by **KENYON E. POOLE**

► *During his recent visit to Europe, KENYON E. POOLE was intrigued by the emerging similarities between the economy of the old world and that of the new. The author, Professor of Economics at Northwestern University, explains why American production and marketing methods are rapidly being adopted, and what place they have in the emerging economic integration of Europe.*

SUPERMARKETS are spreading over Western Europe. While Britain is still the leader, with 500 such stores, France and Italy are rapidly following suit. Thus an institution heretofore regarded as uniquely American is crossing the Atlantic. Indeed, it is a commonplace that the economy of Western Europe is beginning to show more and more of the characteristics of the mass market that began to appear in the United States during the early Twenties.

Per capita real income and personal consumption are rising. The

distribution of income is more favorable to wage earners than it was before World War II. Prejudice against mass produced consumer goods is breaking down, while retailing is becoming more Americanized—that is, the small retailer is facing increasing competition from mass marketing outlets. Europe's railroads are already beginning to feel the competition from new highways, and Europeans today are as air-minded as Americans. Radio and television are doing much to break down regional prejudices and the insistence on time-honored customs that have so long characterized European society.

Why was there such a lengthy lag behind the United States? Why is this lag being rapidly reduced now—instead of 20 years ago, or 20 years hence? Will the European market eventually approximate that of the United States and become oriented toward the needs of the middle and lower middle income groups?

The main reasons for Europe's tardiness in providing the fruits of the Industrial Revolution for all classes are to be found in institutional obstacles connected with political and economic fragmentation, geographical and cultural barriers, and persistent imbalances between industry and agriculture within nations. It must be remembered that European inventors were in the forefront of such important technological developments as the railroad, the automobile, the airplane, radio and television, and the chemicals industry. But Europe has long been cut up into small states, which individually did not provide a large enough market for full development of mass production and distribution.

In addition, high protective tariff walls added to the political obstacles to trade among European nations. Moreover, each nation has often been confronted with difficult problems of its own, in the form of inflation, inadequate and discrimina-

tory tax systems, uneconomic relations between regions, inefficient land distribution and utilization, and, in some cases, high costs of extensive social security systems and nationalized industries. Failure to solve these problems hindered the development both of individual nations and the European economy as a whole.

Added to these difficulties was the persistence of faith in a class society. It was a European tradition that the benefits of rising productivity accrued largely to the upper classes—especially to owners of businesses. As a result, little effort was made to produce an abundance of consumer goods for the working class. But, obviously, mass markets are possible only when the gains of technological progress are widely distributed.

UNDER AGGRESSIVELY competitive conditions, or with aggressive labor unions, more of the profits from increasing productivity would have been channeled into higher wage rates—a development that has been a hallmark of American industrial relations. But, in the past, European businessmen have tended to regard it as improper to lure workers away from competitors by offering higher wages. Moreover, European trade unions have traditionally been far less interested in getting “more and more and more” for their members than have their American counterparts. Their orientation has been largely political, and this has not directly contributed much to forcing the pace of wage rises.

Finally, a long succession of wars has skimmed the cream off Europe's productivity increases. This made both capital and labor favorably disposed toward using much of what was left for the new plant and equipment necessary to achieve a desired rate of growth. An impressively striking exception is Sweden, exempt from the ravages of two world wars.

But the traditional picture is beginning to change. Unless war intervenes, there is every reason to believe that the European economy is rapidly reaching the stage at which the many foci of economic and technological progress will begin to coalesce into an integrated whole. World War II and its aftermath provided the direct stimulus to the de-

velopment of the European mass market. First, there was widespread destruction of plant and equipment. Second, under American prodding and with the assistance of the Marshall Plan, the first steps toward the economic integration of Europe were taken. Third, the people of Europe began to expect and demand a rising standard of living.

As we look at its booming economy in 1961, however, we are tempted to wonder why Europe had to wait so long to move in the direction of American mass consumption. Why did not World War I, itself a powerful stimulus to economic and technical change, produce the acceleration that occurred in the United States? It was that war which paved the way for the rise of mass consumption in this country. Henry Ford received a great assist, in popularizing automobiles in the Twenties, from the permanent rise in real wages that was set in motion during World War I. Despite the inflation of 1919, and the recession of 1921, American working men never lost this advantage.

The picture was quite different in the countries of Western Europe. After World War I it was not necessary to rebuild Europe's plant and equipment. The economy of Europe during the Twenties did not enjoy the opportunity for modernization it has had in recent years. Thus there were no vast increases in output and productivity. Again, unstable currencies and highly nationalistic economic policies greatly augmented businessmen's risks and discouraged the development of really large markets. In France and other countries the fear of German resurgence led to large and costly

standing armies, and to a tax-hungry “Maginot line” attitude among many governments.

Still, the future could be foreseen. Already, in the years following World War I, Bata, the Czechoslovakian mass production shoe company, was giving American firms strong competition for export markets. The vigor of the German steel, machinery and chemicals industries during this period was proverbial. In the Thirties Hitler's promise of producing the Volkswagen—“the people's car”—and the building of the *autobahnen*, though heavily tinged with military objectives, indicated that Germany planned ultimately to democratize transportation.

THE GREAT CHANGES in production and marketing methods in much of Western Europe resulted from World War II, and from the drastic political and economic developments that followed in its wake. By 1947, immediately after the more devastated countries succeeded in making their economies reasonably viable, signs of a desire to forestall future political tensions through closer economic cooperation began to appear. The birth of economic and political cooperation came in 1948 when the Organization for European Economic Cooperation was formed under the terms of the Marshall Plan. Within three years France, West Germany, Italy, Belgium, the Netherlands and Luxembourg had established the European Coal and Steel Community. And in 1957 European cooperation passed a milestone when the same six nations—the “Inner Six”—set up the Common Market.

The postwar climate in Western Europe was highly favorable to the



reduction of trade barriers. Severe scarcities of productive capacity and consumer goods resulting from years of depression and war minimized the desire of nations to keep out foreign products.

The galvanizing force, however, in producing the new postwar attitude of Western Europe toward intra-European trade came from outside. This was the United States' deep interest in establishing an economically and politically integrated ally. Of the total U.S. postwar foreign assistance (1947-60) amounting to \$80 billion, half went to Western Europe. It has been recognized that the resulting large-scale easing of foreign exchange positions deserves much of the credit for the willingness of the Inner Six to move toward closer economic and political integration.

Other factors pushed Europe in the same direction. The replacement of war-damaged plant and equipment provided the opportunity to embody the latest technological advances. This enhanced the European producers' ability to compete in domestic and international markets, and, in much of Europe, reduced the fear of foreign competition. It is also significant, however, that efficient and highly automated plants provide the prospect of a heavy flow of consumer goods; and the latter requires a large and integrated market similar to that in the United States.

INCREASING acceptance of American tastes in consumption and of American business methods has also helped Europe's progress toward a high production, high consumption economy. Consumers abroad have come to know a great deal about American living standards from the millions of U.S. tourists, from American soldiers and their families, and from the ever-widening impact of radio, TV, American movies and periodicals.

Moreover, there has been a large-scale importation of American business and technical know-how. And the desire of American firms to get under the protection of the Common Market, together with the tax advantages that American firms with subsidiaries abroad enjoy, has led to the widespread establishment of branch plants throughout Western Europe. Increasing numbers of American technicians and business-

men have been working in these plants, and others have been hired as consultants by European firms. These developments have contributed to familiarity with American methods and products and, perhaps even more important, with the aggressive mentality of the American businessman.

Another factor in the march toward a high consumption economy



is the progressive breaking up of some of the rigidities of the European class society—in an economic if not a social sense. This has been a somewhat delayed reaction to the years of high demand for labor since World War II. In the earlier postwar years labor leaders recognized that consumption needed to be restrained and that the high profits encouraged by a moderate union policy toward wage rates were necessary to permit a rapid rate of rebuilding and expansion of plant capacity. This was particularly noticeable in West Germany, where a kind of tacit agreement among all social classes made rebuilding the nation the first order of business.

For the first postwar decade as a whole, however, wages rose faster in Western Europe than they did in the United States. For wage agreements cannot hold wage rates down permanently in the face of very high profits and a vigorous demand for labor. Business firms, in an effort to attract and hold labor, have often paid wages above those stipulated in written agreements. This phenomenon of the "wage slide" has become a prominent aspect of industrial relations in a number of European coun-

tries. The result has been an improvement in the economic condition of the working man, thus enabling him to purchase the rapidly rising output of expanded and more efficient plant and equipment. This has benefited the whole economy.

Just as the economic status of the worker is gradually improving in many parts of Europe, so greater attention is also being paid to backward economic regions within countries. Low purchasing power throughout large areas is a constant drag on the economic development of a nation. The potentialities of consumer markets are being more closely scrutinized in terms of greater attention to regional imbalance and uneconomic land use. The argument, familiar in this country, is increasingly being made that high agricultural income helps provide vigorous markets for the output of urban workers.

This argument is becoming important in a country like Italy, in which purchasing power is needed in the South and in Sicily to help provide markets for the industrialized North. Relations between agriculture and industry are precarious in most European countries, however, just as they are in the United States. The problem is likely to be partly solved through migration to industrial areas.

FINALLY, a highly important element in the drive toward economic maturity in Western Europe is the tremendous growth, present and prospective, of the automobile industry. A flood of passenger traffic, much of it across national borders, is certain to lead to the more uniform consumer tastes that are needed to make mass production possible. Again, truck transportation is from door to door, and the mobility it offers makes national barriers to trade seem more and more archaic.

The importance of the automobile industry goes much further, however. American experience bears testimony to the catalyzing effect of mass automobile transportation on a vast network of ancillary industries. These assume great economic importance once the automobile has become thoroughly popularized. Many subsidiary services, such as service stations, motels, restaurants, recreation

facilities and auto parts manufacturing, are provided by small proprietors. Together they represent a substantial core of consumer purchasing power and the capacity to create employment.

CLEARLY, the rapid economic progress made by Western Europe since World War II stems from a wide variety of factors. It would be hazardous to isolate any one major cause. Nevertheless, particular interest has centered on the part played since 1959 by the newly organized trading blocs. These have been, first, the European Economic Community (EEC)—the Common Market made up of France, West Germany, Italy and the Benelux countries—and, second, the European Free Trade Association (EFTA), the “Outer Seven” nations—Britain, Norway, Sweden, Denmark, Switzerland, Austria and Portugal.

These organizations have been going concerns only since 1959 and, therefore, not all of the great progress made so far in liberalizing trade can be attributed to them. Nevertheless, while the philosophy of closer trade relations that lies behind these organizations has been present since shortly after World War II, the formation of the Six and the Seven was an important step along the road to freer trade.

The potential economic effects of the creation of these two groups are very great indeed. The Inner Six have a population of 170 million people and the Outer Seven one of 89 million. The potentialities of the Six are far greater than those of the Seven, and Britain's decision this summer to seek admission to the Common Market was a tremendous contribution toward unification of Europe's market. During the Fifties the trade of the Common Market countries expanded greatly—only Japan exceeded their rate of growth. It has been the objective of the Six to eliminate tariffs against each other by 1970, and this schedule has been tentatively accelerated. Britain's soul-searching decision to apply for membership is evidence of her faith in the “Americanization” of the European market.

Moreover, the Common Market countries stress their willingness to extend this benefit to other countries

on a reciprocal basis. Circumstances do not, however, always permit other nations to accept terms that are deemed appropriate by those who offer them. This has been one of the most difficult problems that had to be faced in connection with Britain's entry into the Common Market.

The Six have, in fact, pursued a liberal trade policy. When the EEC began to operate in 1959 the Common Market countries cut their tariffs by 10 per cent and also made these reductions available to countries not in the Common Market. A further reduction of 20 per cent that is contemplated at the end of 1961 is likewise to be extended to outside countries, though only on a reciprocal basis.

It is clear, however, that the lower the tariffs among the Common Market countries the greater the discrimination against the goods of many outside countries. One consequence will probably be a substantial acceleration in U.S. private investment in Europe—already being made on a large scale and totaling \$4 billion as of mid-1960. American firms want to get under the tariff wall. An important effect, if this occurs, will be another wave of importation of American methods and know-how.

Until Britain's momentous decision to join the Six, the danger existed that Europe might be divided into two rival trading blocs. Many observers had viewed Britain's sponsorship of EFTA as a move in the direction of a new economic regionalism. Such regionalism could have produced a rivalry that would have multiplied trade restrictions not only vis-à-vis outsiders, but also between the two blocs.

Though it might well have been preferable to try to integrate the whole of Western Europe at once, this did not prove to be a feasible objective. To be sure, the 17-nation Organization for European Economic Cooperation did, during the 1950s, succeed in bringing about the abolition of the great majority of import quotas. But it could not take on the job of eliminating tariffs, let alone that of achieving the economic or political integration of Europe. Indeed, one important difference between the Common Market and EFTA has been that, by virtue of their geographical position, the

Outer Seven have very little in common with one another in the fields of either economic or political relationships. It is hard to see how Austria, for example, could be economically integrated with Britain. And Austria, Sweden and Switzerland are neutrals, outside of NATO, while Britain is a key member.

Moreover, the Outer Seven countries do not have a large volume of trade with each other. Yet Britain, though it spearheaded the drive to form the Free Trade Association, has a very large trade with West Germany, one of the Inner Six. At the same time, Britain's traditionally close relations with Canada, Australia and other Commonwealth nations have formed, up to the present, a difficult barrier to economic cooperation with Continental Europe.

But by the summer of 1961, Britain's economic position—and the inadequacies of EFTA—forced her to open negotiations to join the Common Market. This course was deliberately chosen by the Macmillan government despite the hue and cry from many Commonwealth members that London would be sacrificing their interests if Britain joined the Six. The governments of Australia, New Zealand, Ghana and Nigeria made their opposition known to the visiting British cabinet members, who tried to “sell” them the idea of the U.K. joining the “Supermarket.”

Without doubt the ultimate impact of Britain's new economic alignment will be a rearrangement of her trade patterns. Initially, this will be to the disadvantage of the Commonwealth countries and will have adverse effects on exports of American finished goods. But ultimately the acceleration of Europe's growth should benefit all countries.

IN CONCLUSION it has to be noted that the future of Western European economic integration is not entirely rosy. Few gains have been made even among Common Market countries in developing parallel policies with respect to monopoly and inflation control, energy and transport policies, or congruent tax systems. Agriculture remains a very difficult nut to crack. France and Holland are disposed to cease further liberalization of trade until more progress is made

toward a common farm policy. But West Germany is opposed. In essence, there is a severe conflict among the Inner Six, all of which protect their agriculture. Much horsetrading will be necessary before the interests of French wheat and grape growers, of Dutch dairy farmers and of German urban consumers—to list but a few of the interests involved—are harmonized.

Again, despite seasonal migration of workers across national borders, there have been more jobs than workers in Germany during the present year, whereas Italy has been constantly hampered by considerable regional unemployment. But even

the limited degree of economic and political integration achieved by the Inner Six is too much for the Outer Seven. In the long run, a powerful favorable factor, however, is the inescapable circumstance that the countries of Europe must join forces if they are to compete on anything like equal terms in a world of super-states and an increasingly dense network of international economic relations.

There is some question, however, as to what extent Europe will copy America. Will it break down its hoary divisions, founded on language and stemming from the pomp and circumstance of bygone royal courts?

Will it unite in a continental market? Europeans may decide that they cherish many of their differences, and Frenchmen, for example, may not want to give up their Frenchness for a new "Europeanism" fashioned after the American model.

However, if Europeans decide against "Europeanism" and favor, instead, a loose confederation equipped with supranational institutions, as they may well do, that will be a political and social—not an economic—judgment. Nevertheless, at the present time, the prospects look very good for the continued development of a mass European market on the American model. ■

What the new consumer wants

Convenience, Not Status Symbols

by **STANLEY C. HOLLANDER**

► In our rapidly growing service industries the emphasis is not on personal service, but on convenience. Most of America's consumers are more interested in saving time and trouble than in feeding their sense of superiority by having people wait on them.

STANLEY C. HOLLANDER, a long-time observer of the buying habits of consumers, is Professor of Marketing at Michigan State University.

ABELIEF in the importance of service has become a fetish of economic prediction and of business management. Many economic forecasters see the service trades as the growth industries of the future, and most personnel managers keep struggling to develop organizations that will render "service with a smile." Yet one of the great marketing surprises of the 1960s may be a realization that American consumers aren't so keen about service—what they really seem to want is convenience.

In fact, service, in the sense of personal attention, may be an ab-

solute nuisance to the consumer who would like to go about his business with as little fuss and effort as possible. Moreover, as David Reisman points out in *The Lonely Crowd*, much so-called service today is a sort of fake service. Each customer is treated exactly alike, regardless of his needs, but the synthetic greetings and "thank you's" are, as Reisman says, a drain upon everyone's nervous energies.

Convenience, which is one of the consumer's greatest desires, may be described as ease in obtaining ultimate satisfactions. Dean Eugene J. Kelley, writing in the *Journal of Marketing*, uses the term, "convenience costs," to indicate all of the expenditures of leisure, money, and physical and nervous energy that consumers have to make to overcome frictions of time and distance during the process of acquiring satisfactions. Perhaps inconvenience costs would be a more accurate term.

Whatever these costs are called, they include such items as shopping time, parking fees, the frustrations

of dealing with hostile salespeople and the work of deciding what to buy. Kelley is convinced that these costs are becoming more and more important, along with the merchandise or price-tag costs, in a person's decision as to where she will shop and which stores she will patronize.

In one sense service resembles convenience. Service does imply that some people (the servers or servants) work, supposedly, to make life easier and more pleasant for those whom they serve. But there are other overtones as well. Service usually implies human effort and personal attention. We think of a vending machine as providing convenience, rather than service. Similarly, we think of a retail salesclerk as providing some sort of service, good or bad, rather than convenience. Service also suggests a certain type of status relationship between the servers and the served, such as is indicated by the words servile and subservient.

The great American economist and philosopher, Thorstein Veblen, described this relationship very clearly. Writing at the turn of the century, Veblen pointed out that the warriors and leaders in primitive tribes usually delegated all of the hard work in the fields to people of low status, such as captives, slaves and women. Thus, he argued, conspicuous leisure or visible abstinence from useful labor had become a sign of high social status.

But in modern life many of the

highest-ranking people have to resort to a sort of vicarious leisure, since their own positions often demand intense mental and personal effort. Vicarious leisure involves buying and wasting the time of others, and reaches its acme in the accumulation of large retinues of servants, footmen and lackeys. Moreover, servants can best supply vicarious leisure by playing their roles in ceremonious fashion.

Similar standards supposedly influence the lower classes who attempt to imitate their social superiors. Although Veblen wrote mainly of conspicuous and wasteful consumption of products by the most powerful individuals, some modern sociologists have discussed the ways in which the less affluent might purchase small doses of vicarious leisure. Theodore Caplow, for example, believes that the present-day consumer expects and receives a considerable amount of subservience along with her merchandise when she goes shopping.

In the 60 years since Veblen wrote his *Theory of the Leisure Class*, mere free time has become increasingly less significant as a status symbol. Today the business executive and the professional man face 50- and 60-hour workweeks, while the mechanic usually spends only 35 to 40 hours on the job.

Presumably, if Veblen was right, vicarious leisure, the process through which the busy man forces other people to waste time on his behalf, should be even more highly prized as a status symbol today. In such a world practically every businessman who dealt with the public would have to keep increasing the amount of service he supplied. The path to success in retailing, for example, would be through more and more salesclerks, more and more personal attention for the customer.

YET, AS WE all know, some of the most significant modern developments in retailing and in the service trades point in exactly the opposite direction. The spread of self-service retailing is one of the clearest indications that consumers dislike service which is merely time-wasting and inconvenient.

This was not immediately apparent when self-service stores first be-

came popular. The supermarket movement really didn't get under way until the depths of the Great Depression of the 1930s. Many of the most successful of the depression period supers discarded all shopping amenities and concentrated upon offering food at fabulously low prices.

At that time, many successful merchants regarded the supermarket as purely a depression phenomenon. They were convinced that the average customer really wanted to be waited upon by a grocery clerk and that the self-service stores would disappear when prosperity returned.

But most customers found this new way of buying groceries well suited to their taste. The proportion of groceries sold by supermarkets increased steadily throughout the greatest period of prosperity our country has ever known. Apparently many people like being able to select their groceries without waiting for a salesclerk. They like being able to examine merchandise and make decisions at their own pace, and they like not having to apologize if they change their minds. The customers who formerly were embarrassed when they had to ask the clerks for cheaper foods, for pest-killers or for hygienic products like being able to shop anonymously and impersonally. Service, in such cases, is merely an inconvenience.

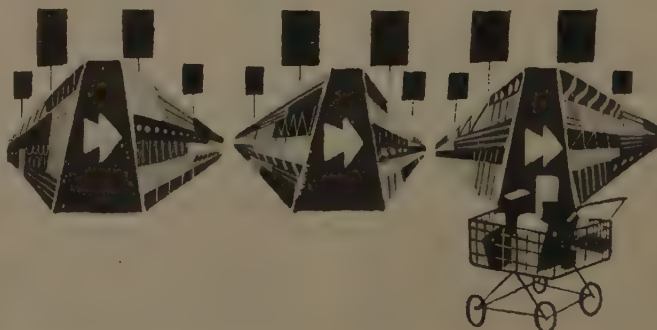
Significantly, supermarket customers are most likely to become irritated at the checkout counter—the one part of the store where contact between customers and store personnel is unavoidable. Here the customer who has been completely free to move about the store is suddenly subjected to control by other people. How long she has to wait for service is determined by the skill of the

cashiers and packers and the number of shoppers ahead of her. As a result, she often resents the whole process of checking out. Undoubtedly the customers will be ready when the supermarkets introduce speedy, automatic checkouts.

Self-service has spread from the food business into many other kinds of retailing. It has been most widely applied in drug, hardware and variety (or 5 & 10) stores. These stores, like the supermarkets, have many relatively inexpensive and uncomplicated items that customers buy frequently. Marketing men often refer to many of these items as "convenience goods," because so many people want to purchase them with a minimum of effort.

RECENTLY a Philadelphia marketing research firm decided that there might be considerable differences between the ways in which women *said* they picked the stores they patronized and how they *actually* selected them. As a result, this firm asked a group of housewives to play some ingenious shopping games and to keep diaries of their shopping trips. Both the experiments and discussions with the housewives showed that many of them really disliked the work of shopping. They tried to reduce their expenditures of time and labor by going first to the stores they felt were most likely to supply their needs. In other words, the desire to minimize "convenience costs" was a crucial factor in shopping decisions.

In recent years, the proportion of total consumer expenditures on services has been growing. The U.S. Department of Commerce reports that about 40 cents out of every dollar consumers spent in 1960 went for services, as against only about 33



cents in 1945. This is a striking increase, even though the service share of the consumer dollar was only about as high in 1960 as it was in 1929, and still is considerably lower than 1933's 45 cents. What is most significant, however, is the trend of growth and decline among the different services.

Domestic service, for example, has experienced one of the sharpest declines in relative importance among all service trades. In spite of rising wages, full- and part-time domestic servants received only 1.15 cents out of every dollar that consumers spent in 1960, as against 1.69 cents in 1940 and 2.17 cents in 1929.

In part, this decline was the result of changes in supply as well as of changes in demand. Restricted immigration, increasing opportunities for education and employment, and the greater mobility of minority groups have cut the number of people looking for work as servants. But workers *do* respond to economic forces and, if consumers were willing to spend enough, servants would be forthcoming. Most consumers today, however, seem to prefer buying substitute servants.

In the United States 2,200,000 people worked as domestic servants in 1940; by 1958, despite a great increase in population, the number had dwindled to about 1,600,000. Veblen pointed out that the use of hired servants often involved many inconveniences for their employers. Menus, mealtimes and household routines in general become controlled and limited, in part, by the skills and schedules of the servants.

THE GADGETS that have replaced servants are not as ostentatious, but they may be much more convenient. They are available 24 hours a day, they are a good deal cheaper, and they present no personality problems. So automatic dishwashers and vacuum cleaners have, to a very great extent, replaced the scullery maid, while prepared foods and kitchen appliances have replaced the hired cook.

Purchased entertainment and transportation services are also among the trades that have received steadily declining shares of total consumption expenditures. Television, of course, is the very simple explana-

tion in the case of movie admissions (the principal purchased entertainment) and probably also in the case of baseball and other spectator sports. Not only does the television screen provide a way of seeing old movies or new ball games that is cheaper than paying admission at the theater or stadium, but it also is much more convenient. More Americans probably see more movies today than ever before—by flicking a switch in their living rooms.

Similarly, the relative decline in purchased transportation is not caused by Americans moving about less. On the contrary, travel mileage is at a new high. But, again, the consumer wants the pleasure of traveling at his own pace, on his own schedule and at his own convenience. Hence the continually increasing reliance on the private auto for both local and intercity transportation.

Most of the other services that have grown in importance over the last 30 years have offered some form of consumer convenience. Some telephone expenditures, such as the use of colored instruments and of multiple extensions, may have been un-



dertaken to impress friends and neighbors. But most of the increase in the share of the consumer's dollar spent on telephones and telegrams has been to reduce the time and effort involved in communications.

Similarly, the increase in bank service charges reflects the widespread desire for the ease and convenience of paying bills by check. Even the rise in payments of interest for consumer and personal debt may be considered an expenditure for convenience, since it has been used mainly to overcome the inconvenience of waiting until one has saved to buy what one desires now.

The same tendency toward offering convenience instead of service can be noted in the changing practices of many service trades, from banks to bowling alleys. More and more routine bank transactions are moving away from the traditional teller's window on the banking floor. Many banks will pay a depositor's routine bills, such as regular insurance premiums, through automatic deductions from his account. The depositor's monthly salary may enter the account through a similar arrangement with his employer. Banking by mail, night depositories and drive-in windows are other examples of conveniences.

MEANWHILE, bowling alleys have become more efficient and more popular since the automatic pin-setter replaced the pin boy. Golf carts have threatened to displace caddies and self-locating golf balls would finish the job. Few travelers seem willing to exchange the ease of taking their own luggage into convenient motel rooms for the ceremony of following bellhops through hotel lobbies and corridors. Airline passengers are showing an increasing tendency to travel tourist class, regardless of how many cabin attendants and champagne bottles grace the first-class section.

One of the most successful recent innovations in airline transport has been a shuttle service between several major Eastern cities. Instead of attempting to lay on an imitation of a state dinner in the Palace of Versailles, this service offers frequent and convenient departures, no reservation requirements, low fares and few cabin amenities. The passengers seem to love it. Now the same airline advertises that it will give first-class passengers the privilege of carrying their own luggage on and off all of its planes, instead of waiting for baggage service.

All of these developments suggest that the average American consumer would rather push a button to actuate a machine than to summon a servant. They also suggest how entrepreneurs may find the greatest growth opportunities in the service trades. Surely it will be by providing new ways of satisfying a consumers' desires—ways that are quick, automatic and convenient. ■

What Goes Up Can Come Down

by BURTON CRANE

► *More than a decade and a half of speculation has forced up prices on Wall Street. Eager amateurs have rushed into the stock market following tips and hunches. Ingenious ways of evading margin requirements have been developed for those who wish to take that risk. Today the market is going through a touchy period and investors—especially the amateurs—should be particularly wary.*

BURTON CRANE is a veteran financial reporter for The New York Times whose book, *The Sophisticated Investor*, is now in its eighth printing.

ACCORDING to the textbooks, gambling creates a new risk; speculation shares an existing risk.

Maybe we should, however, be searching for new definitions, for nowadays new risks are created in order that they may be shared.

Today, when a puzzled investor asks, "What about all this speculation?" he means the raffish speculation in today's stock market—the phenomena of stockholders who can't tell you what their company does; of tips from barbers, taxi drivers and bootblacks; of the ingenious "reasons" advanced as to why this boom is unlike any other in history and therefore can never end.

We have had six "New Era" booms, according to the calculations of James F. Hughes of the New York Stock Exchange firm of Auchincloss, Parker & Redpath. The first started in 1835 and lasted for two years. Then there were booms in 1864, 1881, 1906, 1929 and 1954. In each case the word got around that the country was in a New Era, that the old laws of economics had been repealed and that the tree—this time—would grow right up to Heaven.

From the time that it went through all the old high marks to the time that it ended, each of the first five booms lasted two years or less, according to Mr. Hughes. But the most recent boom, has lasted seven years already.

The end of a New Era boom must be measured emotionally rather than statistically. As Mr. Hughes says: "When the public grows disgusted with the stock market and begins to snarl, 'Never again!' you may say that a New Era boom has ended. Sometimes this has meant a 50 per cent recession from the peak. In the case of our present boom, I should say that 35 per cent would do it. I hope I live long enough to

10 per cent margins were general that the sucker lasted three days to three weeks, the semisucker an average of three and a half years. I have heard today's brokers recall that, when margins were 20 to 25 per cent, the average margin account was "good for seven years."

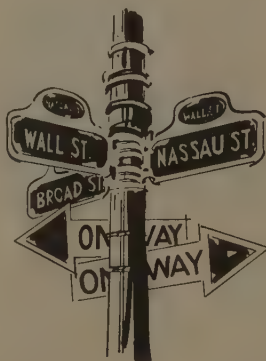
TODAY margins are at 70 per cent. A customer brings in cash or securities worth, say, \$2,000. If the required initial margin is 70 per cent, he divides \$2,000 by 0.7 and finds that he is able to buy \$2,856 worth of securities.

Here is a simple example: you buy a stock at \$100, putting up \$70 and borrowing \$30. The \$70 you have put up is called the initial margin and is required by the Federal Reserve System's regulations.

For its part, the New York Stock Exchange requires its members to see that their customers maintain margins on "long" transactions—that is, deals in which they have bought stock—at 25 per cent of the current market value. This means that when a customer's equity in a stock falls below 25 per cent of its market value, he must put up more money or be sold out. As you can see, a stock has to drop from 100 to 40, a loss of 60 points, before your "maintenance margin" is down to 25 per cent of the market value. In practice, most large firms on the Exchange ask for 30 per cent maintenance margins.

The investor—the man who doesn't play the market on margin—may think himself immune to the influence of speculators. He isn't. They set his prices for him more often than not.

In earlier years a market break used to feed on itself. Margin calls would force stock to be thrown on



see this one end. I want to see who gets blamed for the crash."

One culprit may be the margin control instituted by the Securities Exchange Act of 1934 for administration by the Federal Reserve Board. Small margins used to mean sold-out speculators and quickly-terminated booms. The late Jesse Livermore used to say of the days when

the market at times when nobody wanted to buy. Today, unless he has been using one of the dodges and devices for getting around the margin rules, hardly anybody is forced to sell stock.

When the market turns downward speculators become investors (the Wall Street definition of an investor is "a disappointed speculator"), but today there is no nerve-shattering collapse. Since the present long-term advance began in 1942, we haven't had a downward reaction, measured by the average monthly prices, wider than 18 per cent for all industrial stocks. This kind of constant upward bias naturally stimulates speculation.

The feeling that we are in a New Era has probably been strengthened by the relative stability of our post-war economy, due to government cushions and controls, and Washington's willingness to help when necessary. Since 1949 we have had only two minor annual dips in gross national product and the Industrial Production Index has never dropped more than 10 per cent from any peak to any valley.

Stock prices have advanced far more than the economy as a whole, far more than population growth and far more than inflation—actually, far more than all three taken together. Many investors, however, insist on being comforted by the fact that the economy is growing, even though business and stocks are moving in opposite directions about half the time.

FAR MORE IMPORTANT, I believe, has been our growing shortage of common stocks. We came out of World War II with a shortage in the making because corporations did not have to float stock during the war. The government had been financing the war plants.

Corporation income taxes added to this tendency. In the 1955 "friendly investigation" of the stock market by the Fulbright committee, an official of U.S. Steel explained the difficulty. His company's stock, he said, was then selling in the market to yield six per cent. But, since dividends are paid *after* taxes, Big Steel would have to earn more than 13 per cent in order to pay the federal tax of 52 per cent, plus various state levies, and still have sufficient profits

for the six per cent available for dividends.

But the company at that time was able to borrow at less than four per cent and that cost would be a charge *before* taxes. Naturally, corporations with good credit ratings preferred to borrow. Even today, when the yields of high-grade stocks are regularly below the yields of bonds, the tax situation makes borrowing more attractive than raising equity capital.

Several writers, including Solomon Fabricant of the National Bureau of Economic Research, have noted a tendency toward a more efficient use of capital. In our present context, this means that more and more companies are financing expansion with retained earnings and with depreciation funds. The laws of the past decade that permit accelerated depreciation undoubtedly have made new stock issues less necessary than they might have been.

WE HAVE been talking about influences holding down the supply of new common shares. What about the demand? What has increased it?

First, I should say, we have had a highly successful campaign led by G. Keith Funston of the New York Stock Exchange to interest more Americans in owning common stock. Brokerage houses, advertising more

increased demand for stocks has, I believe, been the rise of the institutional investor. As recently as 1951, noninsured pension funds absorbed only 10 per cent of the new stock issues made available in that year. In 1960 they took 52 per cent. Over the same interval, pension funds and investment companies together increased their share of new issues from 17 to 80 per cent. The share taken by "domestic individuals" (a statistical category including personal trust funds, unincorporated businesses and certain nonprofit institutions) fell from 62 to three per cent.

THUS, in 1960, \$3.4 billion net was available in new stocks. Of this, total pension funds took \$1.8 billion, investment companies \$1.0 billion, other institutions and foreign investors \$0.6 billion. This left only \$0.1 billion for "domestic individuals."

These figures represent first values at time of issue and have no relation to price changes in outstanding shares. But if the supply of new shares is too small and the supply of money seeking investment is large, then the money *must* force upward the prices of existing stocks. This has been our experience. Since the start of 1950 stock prices of industrials have risen about 260 per cent. But gross national product has expanded only about a quarter as much.

That 260 per cent gain, of course, measures the average movement of prices. The main market indicators—such as Standard & Poor's 500 stock index are all heavily influenced by the "standard" stocks, the "blue chips."

These happen to be virtually the only stocks that institutional investors can buy. "If I bought General Motors and the stock fell out of bed tomorrow," an investment manager once told me, "I could not be criticized. General Motors is respectable."

Most of the money invested in stocks by the institutional investors is in 120 issues. Pension fund contributions come in every month and must be invested promptly. Many of the mutual funds sell their shares on monthly payments. There is, accordingly, a constant upward bias in the prices of the 120 "big" stocks that dominate the market averages.



than ever before, have joined with the Exchange President in promoting "People's Capitalism." In a wry aside, we might note that Mr. Funston's two warnings in early 1961 about overspeculation both appeared on stationery urging the reader to "own a share in American business."

The biggest factor causing an in-

Even a rather considerable move to liquidate holdings can be absorbed and promptly nullified by this kind of buying of the key stocks.

THE TWO paragraphs just above may seem to indicate a belief on my part that we are, in truth, in a new era and that prices henceforward will move only upward or, perhaps, that all reactions will be minor.

I should hate to go on record to this effect. Sooner or later one of two things must happen: either there will be a shock to the economy that will bring an important wave of liquidation and make us reassess all our prices for common stocks or the time will come when the returns possible from the big blue chips and the investment funds that feed on them will seem too paltry to be worth the trouble. In either case we are apt to see a cashing in of investment company shares. The investment companies, in turn, will have to sell their "blue-chip" securities.

Perhaps we have already begun to see a little of this—not the cashing in so much as a psychological switch toward stocks that promise greater returns or toward financing arrangements that promise greater leverage.

In fact, it seems that our biggest companies have expanded to about the natural limits of their markets and can hardly expect their earnings to expand any more rapidly than the economy as a whole. There seems to be a natural attrition in earnings, perhaps due to the inefficiencies of great, and necessarily bureaucratic, organizations. Of the 30 stocks with greatest aggregate market values (price times the number of shares outstanding) on the New York Stock Exchange, only 13 added to earnings

as rapidly as consumer prices were rising between 1956 and 1960. Only nine kept pace with both price and population rise in the same period. The average gain of these nine stocks (16.6 per cent in four years) works out to an annually compounded rate of only 3.9 per cent. This is hardly spectacular growth.

Let us further consider these 30 largest stocks. After adjustment for stock splits and stock dividends, an investor who held one share of each would have seen annual earnings fall a little—from \$105.94 to \$105.37—between 1956 and 1960. But between the end of 1956 and mid-August, 1961, the average price of these 30 stocks rose 38 per cent and the average price-earnings ratio advanced from 18.5 to 25.6.

It is impossible to attribute this advance in prices to growth or the expectation of growth. Overall, there was no growth; there was merely a growth of demand for the kind of shares that institutional investors must buy.

There is, however, an underlying feeling generated by all the aforementioned factors that the market as a whole is still rising and is unlikely to stop. This feeling provides an excellent foundation for the kind of speculation we have been witnessing.

BUT A WILD speculative market usually needs something more than a foundation. Some kind of leverage, to multiply possible profits, is required.

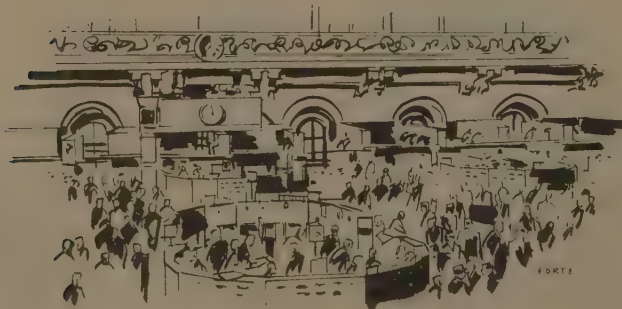
When the demand arises, liberal margin terms always seem to be available to those willing to pay the price. In the year or so before the 1929 crash, for example, most New York Stock Exchange houses moved

gradually away from the time-honored margins of "10 points or 10 per cent." They began to ask for 25 per cent or more. Corporation lenders stepped into the gap and provided the 10 point margins when the market began to slide. Their inexperienced panic selling may have been the main impetus of the sharp collapse in October of 1929.

MOST OF the excited speculation in recent years has taken place with initial margins set by the Federal Reserve Board at either 70 or 90 per cent. Demand from the fast-money boys, however, has developed sources of much more liberal credit. For example, it is possible to open a brokerage account together with a loan account in a European bank. This must be a bank that is not required to report to the Federal Reserve System. That is, it must not have a branch or agency in this country. If the American speculator "gives the execution" to the foreign bank for one and a half times the normal American commission, he may usually borrow 75 per cent of the amount needed. That is, he may carry four times as many shares as he could buy outright.

For a somewhat higher rate of interest, the speculator may make a similar deal at home. Over the past several years specialized finance companies have grown up to lend on stocks. Wall Street calls these "factors," although the regular factors—the firms that finance receivables and provide other financial services for business—wince at the term. The stock market factors will let the speculator borrow 75 to 80 per cent of the amount involved—I have heard of some cases of 90 per cent—at one to one and a half per cent interest a month—and I have heard of two per cent a month.

Partners and employees of New York Stock Exchange firms are not allowed to help customers make such credit deals. The Stock Exchange does not want securities delivered to the "factors." But even this prohibition has been evaded. Now the customer who buys with the aid of a factor gives instructions that the securities are to be delivered against payment to his bank. The bank will then assign the certificates to the factor's account.





Exchange President Funston

Out of this evasion has grown another device for speculation with hardly any money at all. For a charge of one half of one per cent some "factors" have been letting customers "buy" in cash accounts—that is, in accounts that include no borrowed money and require no down payments—with the intention of selling before the delivery date four days away. If all goes well and the speculator does not guess wrong he can multiply his assets briskly, and the factor, for his part, and make up to 30 per cent a year on his capital. But all has not always gone well. Several lawsuits are pending now to force factors to make good on the money their customers have lost by such methods.

As SECURITY in most such specialized finance deals there has been the stop order. It works thus: suppose a customer puts up \$1,000 to borrow \$5,000 and with it he buys 100 shares at 60. If the stock should drop to 50 his margin would be wiped out. But he must also agree to put in an order to his broker to sell him out if the stock ever touches 55. This is a stop order. It becomes a market order as soon as it is "elected" in this manner. From time to time the New York Stock Exchange has banned stop orders in individual stocks, feeling that they exaggerate minor market movements. And last spring the American Stock Exchange banned stop orders in all stocks. Since the prohibition, volume on that Exchange has been far less than that previously.

It is interesting to note that, some time before 1875, a New York Stock Exchange member named Pat

Hearne was using the device now called the "trailing stop-loss order." As his stock advanced, he would keep raising his stops so that, if the market turned against him, he would be automatically sold out. This would either limit his loss or enable him to retain a good part of his profit. My book *The Sophisticated Investor*, which appeared in April, 1959, mentioned the trailing stop-loss order as one of several hundred market hints. *How I Made \$2,000,000 in the Stock Market* by Nicholas Darvas, which appeared exactly a year later, placed primary emphasis upon the trailing stop. By July of 1960, stop orders were massed under the current prices of every speculative favorite. Thus, any downturn would gain immediate leverage.

When few persons use stop orders, they are valuable. When everybody uses them, they are dangerous. Recent printings of my book have advised investors not to have their brokers place stop orders with specialists. Rather, customers are advised to use *mental* stops. If the stock closes at or below the mental limit, sell the next morning.

There is one other factor in this speculative market; it is the low-priced stock, which appears to operate by the "Square-Root Rule." Thirty-odd years ago Fred Macauley discovered that stocks rise and fall according to the movements of their square roots. In other words, if one stock is going from 81 to 100 and a second from 49 to 64, a third will be advancing from nine to 16—a far greater percentage gain. Tests by Macauley, by Harry D. Comer of Paine, Webber, Jackson & Curtis and by the writer show that this has been true within not-too-ragged limits for a great many years. Speculators may not always know the rule but they certainly know the effect.

Speculation in such low-priced issues is, of course, the type we have been hearing most about in the last year. The issues involved might be offered to the general public at five, jump to 12 on the day of offering and sell at 29 within a month.

As I write this in September of 1961, this particular kind of speculation has temporarily ceased. Before me is the current list of recent issues compiled by the National Association of Securities Dealers. Of these,

19 were offered at \$24 a share or less; the average figure was about \$8. If you had bought one share of each at the issue price, you would have made profits on but nine of the 19 and your over-all capital gain would have been 12.4 per cent before transfer taxes. Such a record is profitable but it is hardly glamorous.

Even less alluring is the report of one of the larger and well-established small business investment companies. In a little more than two years it has invested in 18 small business concerns, the best it could find. Fourteen of these were still losing money when this summer ended. Two of the others, however, had been so successful that their parent company was still selling at more than three times its own original issue price after adjustments for a rights offering.

This does not mean that "reality" has returned to the stock markets. It merely means that one of the pots on the back burner is bubbling less actively than it was.

IN CONCLUSION, I should like to utter one or two words of warning:

First, do not imagine that I am telling you to sell or trying delicately to hint that the market is in what our fathers used to call a parlous state. Frankly, I'm like you and have no idea how long the upward drift of prices can continue. Possibly unlike you, I remember that the most publicized prophets of the 1929 crash predicted its coming so far ahead that their followers lost more in profits than they avoided in losses.

Second, do not imagine that I am telling you to buy.

Third, keep your eyes open. Obviously, we have a market that values profits more highly than any other market we have ever had—even the great bull push of 1928 and 1929. But conditions now are not as they were in 1929, in 1937 or in 1946. Business recovery is definitely under way—with industrial production up to a new historic high—but there is a jittery foreign situation. Stocks usually take in their stride "surprises" that were more or less expected.

But surprises that are really surprising are a different matter. Such surprises can send stocks in either direction. ■

SEYMOUR L. WOLFBEIN

Deputy Assistant Secretary of Labor



Automation and the Labor Force

► Although most of the other economic indicators are pointing upward, the unemployment rate (seasonally adjusted) has been hovering at between 6.6 per cent and 6.9 per cent of the labor force for the past nine months. One of the principal reasons for this unusually high unemployment rate at a time when employment is nearing an all-time high is the fact that many workers who have been displaced by automation have been unable to find new jobs. In an attempt to come to grips with this problem, the Administration has recently appointed Dr. SEYMOUR L. WOLFBEIN, the government's chief manpower expert, as head of the new Office of Automation and Manpower.

Q *Dr. Wolfbein, as the government's chief expert on manpower problems, how do you account for the fact that unemployment is hovering around five million during a period when total employment is nearing record levels?*

A To understand the reasons for this relatively high unemployment rate which, incidentally, accounts for almost seven per cent of the labor force, we must first determine who the unemployed are. In order to do this, the Department of Labor divides the unemployed into categories based on the reasons behind their joblessness. There are the *seasonally unemployed*, such as construction and cannery workers; then there are what we call the *frictionally unemployed*, meaning those workers who are changing jobs or are temporarily between jobs. Then we have the *cyclically unemployed*, who are those who have lost their jobs as a result of a downswing in the business cycle. And, finally and most seriously, are what we call the *structurally unemployed*, those individuals whose jobs have been replaced by new technology or who are living in areas which have lost industry.

Q *Which of these four types of unemployment would you say is responsible for our present difficulties?*

A Since both seasonal and frictional unemployment are part of the normal economic pattern of a free society, the heart of the problem lies with those workers who are jobless for either cyclical or structural reasons.

Q *Which of these two factors would you say is paramount in the present situation?*

A It depends on how you define paramount. While cyclical reasons may account for more of the unemployed than structural ones, the structural problem is a much more difficult one to solve.

Q *Is it possible for a sharp upturn in the business cycle to ameliorate structural unemployment as well as that unemployment caused by cyclical factors?*

A While it is certainly true that a rapidly expanding economy will mop up some of the pockets of structural unemployment, it will not solve the basic problem. The structural problem will reappear as soon as the expansion begins to slacken. On the other hand, measures that will solve the problem of structural unemployment cannot be effective without an expanding economy which can provide new job opportunities.

Q *Has the Labor Department attempted to find out what kinds of workers have been most seriously affected by structural unemployment?*

A Yes. Only recently we examined the anatomy of the very long term unemployed—meaning those workers who have been jobless for 27 weeks or more. In looking at this group, comprising more than a million individuals, certain segments of the population stood out very clearly. For example, we found that while the Negro makes up only 10 per cent of the labor force, he comprises about 25 per cent of the long term unemployed. Another group which bulks very large are young people under the age of 25.

Q *What accounts for the fact that these groups loom so large in the statistics?*

A While no one can deny that Negroes suffer from discrimination, we feel that the primary reason for the preponderance of Negroes and young people in these statistics is lack of skills. It might even be said that the statistics are slightly misleading in this respect. According to the figures, the unskilled worker makes up only five per cent of the labor force, but he accounts for 20 per cent of the long term unemployed. While this figure is in itself revealing, the actual picture is probably even worse, since many jobless workers classified as semi-skilled actually have no skills which are salable in today's tight labor market.

Q *Are there any other groups of workers which loom large among the long term unemployed?*

A Industrial workers in general and steel workers in particular have been hard-hit. To be more specific, steelworkers make up 1.5 per cent of the total labor force but almost 10 per cent of the long term unemployed.

Q *Would you say that the steelworkers' plight stems from structural unemployment caused by automation or by the fact that the economy never totally recovered from the 1957-58 recession?*

A The unemployment problem in steel can be traced to both of these factors. An upward trend in the business cycle will certainly ameliorate it, but it can't solve the entire problem of hard core structural unemployment. And, conversely, the structural problem can't be solved without a high rate of business activity. It doesn't do much good to retrain people for new jobs unless the economy can provide them.

Q *Do you feel that the problem of retraining is primarily a federal responsibility or should it be handled at the state and local level?*

A While the federal government certainly has broad responsibilities in this area, the actual retraining job should be done at the local level. Communities which have these problems are far more familiar with them than we are in Washington. The new Office of Automation and Manpower, which I am heading, was set up with the idea that the ultimate solution to this problem lies at the local level. The functioning of our program might be compared to the unemployment compensation system, which is run at the state level under standards set by the federal government.

Four-part program

Q *What methods would the Office of Automation and Manpower use to solve the problem of structural unemployment?*

A We have a four-part program to accomplish this task. The first part is the job of providing information in depth on forthcoming technological developments, especially in such highly complex fields as computers. In fact, we would like to set up an early warning system which will give us this information as soon as possible so that we can feed it back to those sectors of the economy which will feel the labor displacement most acutely. The second part of our program is to get this to the labor-management field where something can be done about it. The third, and most important, part is to take steps to ameliorate the effects on people who have already been affected by the structural changes in the American economy. This, as I mentioned before, would be done through the states and localities. The fourth part of this program comes under the heading of prevention. We can actually prevent the impact of automation on individual workers through forward-looking planning under the auspices of both labor and management.

Q *Has the Administration gone to Congress for funds to implement this program?*

A Yes. The Senate recently passed the Manpower Development and Training Act, which would put this program into effect by a vote of 60 to 31. A slightly different version has already passed the House Labor Committee. The Senate bill calls for a four-year, \$625 million retraining program covering 100,000 unemployed workers.

Q *Has the government found it difficult to get labor, on the one hand, to accept automation, and management, on the other, to assume certain responsibilities in mitigating its impact?*

A Although there are always examples of unions who resist technological change, and companies which abdicate their responsibilities to their workers and to the community, the vast majority of unions accept automation and most businessmen are willing to assume their responsibilities toward easing the transition.

Changed attitude of business and labor

Q *Would you say that this increasingly responsible attitude on the part of business and labor is a very recent development?*

A While an attitude is something which is difficult to measure, I think it is fair to say that, in general, both management and labor have become much more aware of their responsibilities in this area in recent years. The overwhelming support which the Senate gave to the Manpower Development and Training Act is evidence of the prevailing attitude.

Q *What would you say are the reasons behind the changing attitude?*

A I think that the rapid pace of automation in the past few years has brought an awareness of its human impact into practically every community in the United States. This has been accompanied by considerable publicity in the press and on television about the high rate of structural unemployment, particularly in depressed areas.

Q *Although, as you mentioned before, many labor unions are cooperating with employers in the installation of automatic equipment, there is still a public image of a resistance on the part of labor. Could you give us some examples of unions which have encouraged this trend?*

A Certainly. I think that both the plumbers and the typographical workers unions are outstanding examples of those labor organizations which have taken upon themselves the costs of retraining their members for the new technological age. The typographical union has trained its members to handle the new giant machines which, although they are labor displacing, have brought down costs and created new business for the industry. The plumbers union has trained its members for new jobs in the atomic energy field. These programs are not inherently altruistic; they are just plain good business sense. The unions who are resisting automation, in many cases for perfectly understandable reasons, will find that, in the long run, they are hurting their members by not helping them to adjust to new realities.

SEYMOUR L. WOLFBEIN

Q *In preparing the labor force for automation, most of the emphasis seems to be on the retraining of workers whose skills are no longer required. What is being done to train the young people who are about to enter the labor force for the job skills that will be needed in the years ahead?*

A The problem of training new entrants into the labor force looms even larger than the retraining of displaced workers, since about 26 million new workers will enter the work force in the decade ahead. That is why the first two parts of our program are so important—that is, gathering the latest information on skill requirements and then feeding it back to the guidance and counseling systems of the educational institutions so that adjustments can be made in both the curriculums and the career counseling.

Structural unemployment abroad

Q *How have other major industrial nations coped with the problem of structural unemployment?*

A Although I am certain that every advanced industrial country is facing this problem in one form or another, I can only discuss those countries with which I am familiar. For example, Sweden, where I just recently spent some time, has gone a long way toward meeting this problem. In fact, the unemployment statistics released while I was there indicated that only 1.2 per cent of the labor force was jobless. And the rates in other countries of Western Europe are correspondingly low.

Q *How do you account for this?*

A In Sweden, the government, through various fiscal, monetary and investment devices, pursues an active policy of keeping the economy going at as high a rate as possible. At the same time labor and management jointly sponsor extensive retraining and relocation programs.

Q *Since both the size and technological development of Sweden are dissimilar to the United States, is it fair to say that its low unemployment rate can be easily transferred to the U.S. if the same policies are followed?*

A Of course, I have to admit that Sweden is in a much earlier stage of automation than we are and that it is much easier to solve these problems in a nation of seven and one-half million than in one of 180 million. But I still feel that when you adjust for these circumstances it is still the combination of government and private programs which has eased the transition and kept the unemployment rate at so low a level. And despite the differences in our economies, I think that we can learn a lot from the Swedish experience.

Q *Is the Swedish unemployment rate of 1.2 per cent based on the same criteria used in the United States?*

A Yes, it is based on exactly the same criteria since the Swedes adopted our system of gathering unemployment data about a year ago. Interestingly enough, the United Arab Republic, which has an economy far different

from Sweden, is another nation which recently adopted our statistical techniques in this area.

Q *Just what are these statistical techniques and how do you gather the information on which you base your monthly reports on the labor force?*

A We use three different methods, which we integrate and analyze, to assess the monthly status of the American labor force. The first one, which we call household enumeration, is probably the most familiar. We have a group of about 500 enumerators whom we send out every month to a scientifically designed sample of households. These households are located in 333 areas covering all of the 50 states. Through a series of questions we determine their over-all employment status, how many people are employed, how many are unemployed and how many are outside the labor market altogether.

Q *Do you feel that the sample taken by these 500 enumerators is accurate enough to produce reliable data?*

A Yes, definitely. If you have a scientifically designed probability sample—which we do—you can mathematically calculate the range of error. In any case, household enumeration gives us over-all figures on the age, sex and occupational composition of the unemployed.

Other methods of gathering data

Q *What are the other methods you use in addition to household enumeration?*

A We get reports from the local offices administering the unemployment compensation program on the people who are drawing unemployment insurance. In fact, we get this information weekly. It gives us the number of individuals collecting benefits and the localities in which they reside.

Q *I think you will admit that this method has certain flaws since a good many unemployed workers are either not eligible for or have exhausted their benefits.*

A This is certainly true. Although it varies with the business cycle, you will usually find that only about 60 per cent of the unemployed are collecting benefits. One reason for this is that only about two-thirds of the labor force is covered by the program. In answer to your question, I would agree that this method has flaws, but it is only one of the three techniques we use to gather our data. Our final conclusions are based on the information we obtain through all three methods.

Q *What is your third method for gathering this information?*

A The third method, which is a very important one, is the oldest of the three. Each month about 180,000 employers report to us by mail on how many people they have on their payrolls, how many hours they worked and what they earned.

Q *Are employers legally obligated to furnish these reports?*

A Interestingly enough, they are not. It is a completely voluntary program. Although there are always a few

people who don't cooperate, our record of compliance is practically 100 per cent. This voluntary program has been going on for decades and is an integral part of our information-gathering system.

Q *How long has the government been issuing these statistics?*

A While many of them go as far back as World War I, the principal components of the present system—the household enumeration survey, for example—began in 1940. But it was only in the last few years, however, that this whole system was coordinated and placed under the Department of Labor.

Q *Would you say, then, that the unemployment statistics of, say, 10 years ago were issued under different criteria?*

A No. While the administrative setup was different, the criteria were the same.

Q *How long have the present criteria been used?*

A The present criteria go back to 1940. In fact, you might say that we in the United States were virtual pioneers in this field. As a consequence, our techniques and standards are so widely respected that public acceptance of their accuracy is almost universal.

Q *I am sure you will admit, though, that there has been some criticism from people who say that your figures underestimate the situation and from some who say that they magnify it.*

A Yes, certainly. But the fact that the little criticism we receive comes from both sides is a good indication of the fairness and accuracy of our methods.

Q *How, for example, do you feel about the recent statement of Sen. Paul Douglas (D-Ill.) that the unemployment rate would be closer to 11 per cent if proper weight were given to factors such as part-time jobholding?*

A Sen. Douglas is perfectly right in saying that if a man only works part time he is counted as employed. In fact, if he only works one hour in a given week, he is

counted as among those holding a job. Our unemployment statistics include only those people who have been actively seeking work and have had no gainful employment at all during a given week.

Q *Is the Senator, then, right in saying that your figures underestimate the situation?*

A Let me sum up my reaction to the Senator's criticism in this way. His reason for wanting to add to the unemployment statistics those who are involuntarily working just a few hours a week is perfectly understandable. We feel, however, that a man who is underemployed, rather than unemployed, is in a different position. He is not completely cut off from a job situation. He still reports to his place of work and is building up seniority. His chance of getting more work as soon as business begins to pick up is far better than for the man who is jobless.

Breaking down the statistics

Q *What is your reaction to the criticism from those who feel that your figures are unduly pessimistic? For example, Todd and Draper, the management consultants, have recently stated that it was misleading to place housewives, teen-agers and those workers who were in the process of voluntarily switching jobs in the category of the unemployed.*

A Our answer both to those who feel that the statistics are overstated and to those who feel that they minimize the situation is that our breakdowns of the total figures provide precisely the information which they seek. Our breakdowns cite the number of part-time workers, the number of individuals voluntarily switching jobs, the seasonally unemployed, etc. These statistics are available for anyone who wishes to examine them.

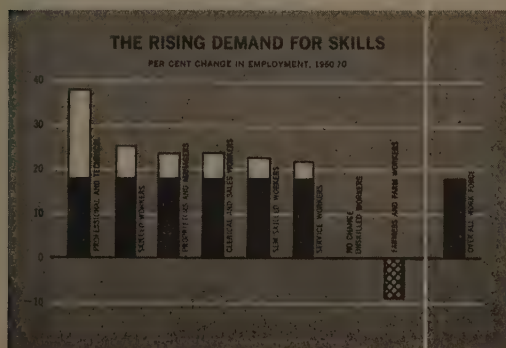
Q *I am sure that both of the critics cited above realize this. What they are driving at is that the general public, which does not examine the statistical breakdown, sometimes gets an erroneous impression of the actual situation.*

A I am afraid that this gets back to the perennial problem of selling newspapers. The aggregate figure, obviously, makes a better headline than the detailed breakdown.

Q *Have you attempted to correct this situation?*

A In our monthly press conferences, in which we release the latest figures, we have tried to emphasize the meaning of the various components of the over-all picture. I must confess, however, that, with the exception of a few publications like *The New York Times*, most newspapers fail to interpret the significance of the various components. With radio and television, of course, the problem is even more acute, since their treatment of the problem may involve only a few seconds of a short news summary.

Q *Despite these shortcomings, I think you will admit that both the press and television have given an increasing amount of space and time to the problem of unemployment.*



By 1970 the labor force will increase by about 13.5 million, according to Labor Department estimates. The demand for skilled workers, however, will rise even faster.

SEYMOUR L. WOLFBEIN

A Yes, they certainly have. These media have been principally responsible for the increasing public awareness of the problem of depressed areas, structural unemployment and automation.

Q *Dr. Wolfbein, wouldn't you say that the problem of structural unemployment is bound to grow worse? Isn't it possible that because of increasing automation we will have twice as many workers jobless in, say, 1965?*

A It is a definite possibility. We feel, however, that if we act now and plan carefully we can make an appreciable dent in the number of workers affected by structural unemployment. That is the purpose of our four-point program currently before Congress.

Q *In other words, you feel that this could be a serious problem, but that it doesn't have to be?*

A Exactly. Progress always creates problems. If you examine most of the beneficial developments we have had in this country, you will find that each of them created problems. Take, for example, the marked increase in longevity over the past 50 years. This has certainly brought our society new problems. Medical care for the aged, for instance, was far less of a problem when the life span was much shorter. But, obviously, nobody would be against increasing the life span just because it brought with it the problem of caring for the aged. The same can be said for the human problems created by the impact of automation. Although it can hurt certain groups of people in the short run, in the long run technological change brings a higher standard of living to a whole society.

Tomorrow's labor force

Q *In what areas of our economy do you see this problem looming the largest in the years ahead?*

A In terms of total numbers, there is no doubt that our most difficult problem will be with young people. After 1965 we are going to have almost four million boys and girls reaching 18 each year. This compares with only three million now and two million 10 years ago. These youngsters must be trained in the skills that our economy will require in the years ahead. As the years go on there will be fewer and fewer jobs for those who are unskilled. At the same time, of course, our economy must be operating at a rate which is high enough to provide jobs for these young people. As I said before, it's a dual problem. Workers must acquire new skills and the economy must provide the jobs to put these skills to good use.

Q *What is your prediction as to our success in handling this problem?*

A Because of the increasing public awareness of the nature of the problem, I think we have a very good chance of licking it. To be even more positive, I think that we will lick it because we must if our system is going to survive the hard realities of competitive coexistence with the Soviets. We are constantly talking about economic growth, but the only way to increase

our growth rate is through the use of new technology.

Q *In addition to the problem of training, would you agree that another basic problem in structural unemployment is getting people to leave depressed areas?*

A As the author of many articles on the changing geographic pattern of American industry, I have thought long and hard about this problem. Basically, it is one of making people more mobile. There are many older workers, of course, who have strong personal ties in a particular locality and can never bring themselves to leave. But these, I feel, are a distinct minority.

Labor force mobility

Q *How can you make people more mobile?*

A For one thing, mobility goes back to the problem of retraining. A skilled worker is far more mobile than an unskilled one. In addition, we are hoping that developments will occur which will make it easier for a worker to move to another industry or locality without losing all of his seniority and benefits such as pension rights. In the area of retirement benefits, we call it the vesting of pension funds.

Q *Could you explain how this would work?*

A Certainly, it's very simple. Take my own case, for example. As a federal employee, I come under the Civil Service Retirement System. If I should transfer from Washington to another government department in, say, San Francisco, I would still be under the same retirement plan. My transfer would have cost me nothing in benefits. In most private industries, however, if you leave a company or a particular area, you lose all your benefits.

Q *Do you feel that such a system could be worked out in the private sector?*

A Well, as a starter, it could certainly be worked out on an industry-wide basis. It would, naturally, require the cooperation of management, labor and the actuaries of the insurance companies. But American know-how has solved far more complex problems than this one. In any event, a start in this direction would certainly be a help in encouraging labor mobility from areas of substantial unemployment.

Q *Do you feel that the government has a role to play in pushing this along?*

A Yes, in the sense of encouraging industry to work it out by pointing out the advantages to all concerned.

Q *To sum up, what would you say are the principal pathways for easing the impact of automation on the labor force in the years ahead?*

A The first step was the Area Redevelopment Act, or depressed areas bill, which Congress passed last spring. The second is our Manpower Training and Development Act. Coupled with these governmental measures are the actions which the private sector can take in matters such as the vesting of pension funds and joint labor-management retraining programs.

Q *Thank you, Dr. Wolfbein.*

EXPORTS—LIFEBLOOD OF JAPAN

by WALLACE L. HIGGINS



► Since 1945 WALLACE HIGGINS has lived in Japan; he served for two years as a member of Gen. MacArthur's staff, and for the last decade he has been a consultant to leading banks and industries. Mr. Higgins now lives in Yokosuka with his Japanese wife. In this article he examines what has caused Japan's rapid rate of growth and explains why he thinks it will continue. Trade, he points out, is the lifeblood of Japan; and he warns the United States that trade is a two-way street—that if we are to go on increasing our exports to Japan we must go on accepting more Japanese imports.

TOKYO

CAN THE BOOM here continue in the face of growing American resistance to inexpensive Japanese imports? Every foreigner who comes to live in Japan discovers that the Japanese find it quite difficult, if not impossible, to accomplish results in accordance with Western formulas. They must do it their own way, but, to the amazement of everyone, they come up with the same answer. It remains a case of the antique abacus producing the same answer as an IBM calculator and taking about the same amount of time.

As a long-time resident of Japan who has been privileged to serve as adviser and consultant to some of the country's leading businesses, I should like to stress the fact that there is more to understanding Japan's economy than studying neatly arranged statistics.

Nevertheless, some statistics will help to point up Japan's problems and prospects. Japan's population is some 93 million; its area is 143,000 square miles, making it a little smaller than California. A shortage

of fertile land and natural resources results in Japan's importing more than 10 per cent of her food and 80 per cent of her raw materials. Despite these handicaps, the country's gross national product rose at an average rate of more than nine per cent a year between 1950 and 1960. During the same 10-year period Japanese exports rose by more than 400 per cent—from \$820 million in 1950 to about \$4 billion in 1960. In the latter year more than a quarter of these exports, worth about \$1.1 billion, went to the United States.

I have discussed the present boom with scores of Japanese industrial and financial leaders, and the consensus among them is that it is going to continue. They expect the pace to slow slightly from the hectic rise of the past two years; economic growth was at a rate of 17.7 per cent in 1959 and 11 per cent in 1960. The 10-year plan adopted by the incumbent Ikeda government calls for doubling the national income by 1970 and an annual growth rate of nine per cent during the next three years. This will be achieved.

If the Japanese are temporarily stymied in one area by such developments as "Buy American" campaigns, European trade cartels, trading blocs or enforcement of GATT escape clauses—developments that limit their exports to one or more countries—they will shift their efforts to other fields where there is less resistance. As a nation that processes imported raw materials, trade is necessary for Japan's survival—and the Japanese intend to survive.

WHAT MAKES the current expansion so remarkable is the contrast with the virtual stagnation of the early postwar period. This stagnation

resulted from a number of causes: the widespread wartime destruction, the apathy that followed the shock of losing the war after years of nerve-straining effort, and the policies of the U.S. occupation. The occupation authorities, by dismantling the Zaibatsu cartels—the handful of family run organizations that dominated the prewar Japanese economy—purging the nation of its industrial leaders and encouraging the irresponsible growth of the labor unions, produced, economically, a rudderless ship.

Just as in West Germany, where economic recovery can be said to have begun with the currency reforms of June, 1948, Japan's economic resurgence can be dated from the arrival of the Dodge Mission in 1949. The anti-inflation program proposed by Mr. Joseph Dodge (who subsequently became director of the U.S. Bureau of the Budget) and implemented by Mr. Ikeda when he was finance minister in the Yoshida government, marked the beginning of Japan's economic recovery. The stringent measures adopted to balance the budget, enforce savings and limit the production available for the domestic market succeeded in putting Japan on the road to industrial expansion while keeping prices in check.

The stabilization policies recommended by the Dodge Mission were wholeheartedly subscribed to by the Japanese government. Then came the Korean war, which focused attention on Japan's importance to the free world and gave the economy a well-timed shot in the arm.

But for several years following the cessation of hostilities in Korea, the economy continued to operate on a shoestring. It was saved from infla-

tion and collapse by the government's strict controls, the large-scale spending by the U.S. military forces and a number of foreign loans. The people could buy little more than the barest necessities. Japan's industrialists maintained high dividend rates and encouraged the little man to purchase securities. This made it possible for them to strengthen their firms through increased capitalization. And government loans and ex-

loans and increased capitalization. Extensive plant modernization and increased capacity are resulting in higher productivity, although productivity is still low by Western standards. Japanese industry, however, is now in a strong competitive position.

This competitive position is being reinforced by the reappearance of the old Zaibatsu trading companies and the emergence of such new, fully

subishi because some of these former associated companies, such as Tokyo Shibaura Electric (Toshiba), have developed their own strong sales organizations, and because of the strong competitive position of other trading companies and the control exercised by the banks. Through mergers and stock control, Mitsui is entering such new fields as petrochemicals, oil refining and atomic energy. Mitsui interests are also penetrating the heavy industry field formerly dominated by Mitsubishi.

Challenging Mitsui and, to a lesser extent, Mitsubishi, is Hitachi, the new Zaibatsu. This company is making a bid to become a major competitor in all fields (except perhaps banking and insurance) with the former Big Three, including the new areas of petrochemicals, oil refining and atomic power. Sumitomo, the third of the Big Three, has entered the heavy industry field by acquiring Uraga Dock (shipbuilding) and Meidensha (heavy electrical machinery). These mergers are marked by the formation of holding trusts comprising a group of many industries—mining, shipbuilding, manufacturing, chemicals, oil refining, transportation and banking—with each component diversifying its own output.

Although the trend appears to be a reversion to the old Zaibatsu, the new generation of business leaders doubts that such trading companies will dominate the economy to the extent they did before the war. New competitors have arisen and the struggle for top control today is no longer limited to the trading companies, but includes the banks, securities houses and individual enterprises. The banks now appear to have the greatest control over individual industries, but the intense struggle of the trading companies to regain their former dominant position could lead to an explosive situation. In this area, as in others, however, Prime Minister Ikeda can be expected to exercise firm control to see that proper balance in the economy is maintained.

Politically, the new Zaibatsu have little influence except through campaign contributions, a position very similar to that of American industry. Moreover, they are still controlled to a great extent by the Ministry of



port subsidies helped them to modernize their plants.

To keep the national budget and taxes low, as officials admitted privately, many urgently needed public works projects were postponed. In addition, the financial burden of defense expenditures was carried by the U.S. Now, after several years of austere but balanced budgets, the Japanese government is allocating substantial funds for the improvement of highways, harbors and sanitation. In fact, projected government expenditures under the 10-year plan will be almost entirely to build up social capital.

TODAY the economy is entering a new phase, which might be termed a consolidation after the feverish expansion of the past few years. Business leaders acknowledge that the country's economic base, because of a lack of capital, is still narrow, but they point out that it is much wider than it was several years ago. The financial structure of individual companies remains weak because of their heavy dependence on bank loans to finance current operations. The continued industrial expansion of private industry will be financed from private sources, including foreign

integrated Zaibatsu as Hitachi. Of the old Zaibatsu, Mitsubishi Shoji has come closest to achieving its former position as a fully integrated cartel. Decentralized by order of the American occupation authorities, Mitsubishi began gradually to regain control over its former affiliates after the peace treaty was signed in 1951. It did so through exclusive trading agreements with some manufacturing companies and through the purchase of equity stocks in other firms. Most manufacturing companies lacked sales and business talent, which made it easy for the trading company to work itself into a commanding position.

Today Mitsubishi either controls or is affiliated with 27 companies covering such diversified fields as fuel importing and processing, ferrous and nonferrous metals production, heavy machinery, shipbuilding, automobile and aircraft production, textiles, petrochemicals, food processing, paper, leather and rubber production, banking, real estate and insurance.

Mitsui Bussan, the second of the prewar Big Three Zaibatsu, is also trying to regain control over all of its former affiliates. Mitsui has not succeeded to the same extent as Mit-

International Trade and Industry (the omnipresent MITI) and the Ministry of Finance. No import or export license, no loan, no trade agreement or licensing arrangement can become effective without MITI approval. This approval is generally given on a basis that follows the Zaibatsu pattern. In other words, MITI is protectionist, it is committed to limiting competition while preserving existing companies, both weak and strong, and it seeks to distribute work as widely as possible.

Although, in sharp contrast to pre-war days, Japanese industrialists must deal with organized labor, the influence of Japanese labor unions is minor compared with that of their U.S. counterparts. Japan's traditional paternalistic relationship between employer and employee makes it difficult for the unions to offer much to their membership. Labor mobility is low and the union organizers face a hard struggle to increase their membership. Japanese businessmen, in general, do not take unions too seriously. But in the fields of teaching and government, their influence is greater and could be a source of trouble.

WHITHER is Japan moving today? Economically and politically, she will remain tied to the West, particularly to the United States. In the widespread publicity given to state-

ments by both American businessmen and union officials on "excessive Japanese imports," it is usually overlooked that for the past 10 years, with the exception of 1959, Japan has been buying more from the U.S. than she has sold.

Last year Japan was second only to Canada as America's biggest customer, purchasing \$1,300 million worth of American goods, while selling \$1,100 million to the U.S. Yet this fact has only begun to be exploited by the Japanese who have, until recently, failed to assert themselves on this matter to Americans. Instead, they quietly went about rehabilitating their cities, rebuilding their industries, in many ways pulling themselves up by their bootstraps.

Through improvisations and skillful manipulation they have succeeded in avoiding inflation and in putting their economy on a firm basis. This has been achieved at a price. As a sensitive people, the Japanese have had to battle an "inward conscience" or feeling of guilt over their inability to meet both national demands and international commitments. Japan's leaders are aware of the need to spend more for her own defense, for public works which the U.S. has been asked to help finance and for aid to the underdeveloped areas. Now that their economy is on a much firmer foot-

ing the Japanese are beginning to move in this direction.

Today Japan is reasonably strong economically. While Japan's political future is by no means settled, it appears more promising than ever before. And, with their economy on a firm basis, the Japanese are now in a position to take more positive action in world affairs. As a consequence, Mr. Ikeda and his successors will become more and more effective in promoting the affairs of Japan both at home and abroad.

AMERICANS must not mistake this change in attitude as being too aggressive or as being in any way hostile. It is a logical and necessary step after a long period of compromise and apology. It will be good for Japan and good for the world if Mr. Ikeda succeeds in producing greater patriotism and pride among the Japanese people. In his polite remarks to Congress during his recent visit to the United States, Mr. Ikeda said that foreign trade must be a "two-way street." This certainly demonstrated that Japan is now prepared to stand up to its critics in the United States. The postwar era of humility has ended.

From my conversations and observations, I believe that Mr. Ikeda's policy is based on promoting U.S. trade as the immediate target and trade with Southeast Asia as the long-range objective. Present trade with the U.S. is necessary to maintain a favorable dollar balance but as much effort is being put into long-term development in Southeast Asia as the Japanese economy can afford. The Japanese are fully aware of the great need for developing this market and they have already had considerable experience in and knowledge of this region.

The rate of economic growth called for in the 10-year plan will be reached or even exceeded. Capacity will be further increased, labor more economically utilized. Japanese industrialists are looking toward the day when productivity will have improved to a point which will make it unnecessary to emphasize price competition in international trade. Then they will be able to rely more on the quality of their goods to sell them abroad. Through more aggressive sales promotion, better public rela-

TRADE WITH COMMUNIST CHINA?

JAPAN, like Britain, must export or die. In 1960 Japan's exports represented approximately 11 per cent of her gross national product of \$38,669,000,000. The 1961 export program adopted by the Supreme Export Council (a combined governmental and business group that sets export targets and makes plans for implementing them) established a goal of \$4,540,000,000 in exports, a 10.3 per cent jump over 1960 figures.

Trading circles greeted this announcement with reserve and pointed to the need for plans to open new markets, particularly in Communist Asia—Communist China, North Korea and North Vietnam.

As the United States is Japan's leading customer, Prime Minister Ikeda has so far avoided giving any public encouragement to advocates of increased trade with China. The area remains, however, Japan's great natural market. Business leaders fear that if and when Britain joins the Common Market, further restrictions will be imposed on Japanese exports, not only by the Common Market but by Scandinavian and Commonwealth countries as well. Should threatened U.S. limitations on Japanese exports also materialize, pressure on the Tokyo government to open new markets in Communist Asia would heighten.

Present government leaders would contemplate such a step only as a last desperate measure, fully aware of the serious repercussions it would hold for trade with the United States.

tions and a cartel-type of control, the Japanese will become more and more competitive in world markets.

Mutual trade, however, is not the only facet of Japanese-American economic relations. For instance, there are indications that American industry is becoming aware of the advantages of using existing Japanese facilities, instead of increasing its own capacity, to process raw materials for Far Eastern markets.

One such agreement was recently

made between the Japan Steel Works and a large U.S. steel company. Japan's steel capacity is now fully employed but for years there was much idle capacity—during a period when American steel facilities were being rapidly expanded. Singer sewing machines are being manufactured in Japan by a joint company, Pine-Singer. And the National Cash Register Co. and Hamilton Watch are other firms using Japanese labor and facilities. An increasing number

of such arrangements are being worked out.

If American businessmen recognize the great potential of a cooperative effort with Japanese industry through such mutually profitable agreements, Japan's tremendous resources of energy and talent can prove beneficial to both nations. If they fail to do so, and if they follow a policy of containment, the dam will burst and the waters will flow into other channels. ■

Financing public needs

A Nationwide Treasure Hunt

by HARVEY E. BRAZER

► *What are the obstacles the various levels of government face in obtaining additional funds to eliminate "public squalor"? HARVEY E. BRAZER reviews the performance of the public sector over the past 12 years and concludes that those obstacles are primarily political rather than economic.*

When this article was written, the author was Professor of Economics at the University of Michigan. He recently became Director of the U.S. Treasury's Office of Tax Analysis.

WE CERTAINLY have a high standard of "spending" in the United States, but do we really have a high standard of "living" as well? Debate on this question has raged ever since J. K. Galbraith indicted the U.S. in *The Affluent Society* for permitting "public squalor amidst private plenty."

Certainly, we have been spending more and more—on bigger television sets, smaller radios, newer cars, higher-fidelity phonographs and further-flung vacations. But at the same time, for lack of funds, schools are dilapidated and overcrowded; mass transportation systems are allowed to deteriorate though traffic congestion threatens to strangle our cities;

streams and rivers are polluted; urban renewal lags while slums spread; prisons and mental hospitals have become "warehouses" rather than rehabilitation centers. . . . The list could be extended indefinitely. It is almost impossible to pick up a newspaper or magazine today without learning about the great need for more funds in these or other areas of our public sector.

But have we really been so niggardly in our contributions to the support of the public sector? If more money is needed, what are the obstacles to securing it? Can these obstacles be overcome, and, if so, how?

To begin with, let us examine the first question. What *does* the record show about our support of the public sector? A glance at some figures on government expenditures suggests that there has been a tremendous increase in outlays for public services since 1948, when postwar "normalcy" may be said to have been attained. In that year our local, state and federal governments together spent about \$50 billion. By 1960 the figure was almost three times as much in current dollars. And in that year, state and local governments alone spent more than \$50 billion.

Less than half of the total in-

crease in expenditures by all levels of government is accounted for by defense and foreign aid. In the domestic field, on the other hand, expenditures for education have increased from \$8 billion to \$20 billion, for highways from \$3 billion to more than \$10 billion, for health and hospitals from \$2 billion to \$5 billion. Other major domestic programs have seen similar growth.

During the dozen years between 1948 and 1960 government expenditures have increased relatively as well as absolutely; they now account for about one-third of our national income as opposed to less than a quarter in 1948. However, not all of the sum involved constitutes a drain on national income, for transfer payments account for about one-fifth of government expenditures. (Transfer payments—i.e., interest on the national debt, social security payments, veterans' pensions, etc.—do not absorb resources; they merely transfer money from taxpayers to bondholders, the indigent aged, dependent children, military pensioners, etc.) Nevertheless, it is clear that we now devote a considerable portion of our resources to public services.

Thus, we find, in looking at the aggregate figures, that the public sector appears to have been doing quite well. Why, then, are there still so many deficiencies in the supply of public services throughout the country? One reason is that about two-thirds of all government revenues go to the federal government. Yet the federal government is not directly responsible for providing many of the public services that are essential to the well-being of the economy as a whole. Most of them are supplied

by states and local units—cities, villages, counties, townships, school and special districts.

Despite the fact that expenditures on the state and local level have increased at an average annual rate of about 10 per cent for the past 12 years, not much headway has been made in improving the quality of public services. In fact, because of inflation of costs, and changes in the size and composition of the population, state and local governments have had to keep running merely in order to stay in the same place.

CONSIDER, first of all, the effects of inflation. Between 1948 and 1960 prices of the components of gross national product rose by an average of 30 per cent. But, during the same period, prices paid by state and local governments for goods and services (including construction and employees' wages) went up 55 per cent. Thus, state and local expenditures, in terms of constant dollars, hardly doubled during this period, increasing from \$17 billion to \$32 billion—not to \$50 billion.

A second major factor that has made it difficult to provide adequate public services has been the growth in numbers and change in the composition of the population. Since 1948 the number of people in the United States has increased by some 25 per cent. Considering the impact of inflation plus this population increase, state and local units would have had to spend \$33 billion in 1960 (almost double the amount spent in 1948) merely to supply the same volume of public services *per capita* in 1960 as in 1948. But even laying out that sum would *not* have maintained the quantity and quality of services per person. For the numbers of the aged and the very young—the groups which use the public services most—increased far more rapidly than the population as a whole.

Moreover, the postwar expansion of suburbia has required vastly increased outlays for schools and other public buildings, for sewers, street lighting, parks, water mains and other facilities. In the metropolitan centers, as well, new needs have emerged—for improved schools, for larger colleges, for arterial highways, parking facilities, and urban renewal

and redevelopment, to mention only the most obvious requirements.

These are the reasons why state and local governments have been forced to expand their expenditures very rapidly merely to maintain the status quo. Very little of the ostensibly large increase in their expenditures has been available to raise the quality of services—or even to meet the backlog of needs that accumulated through the long years of the depression and World War II.

Much has been made of the in-

any, dramatic increases in state tax rates; and no new sources of tax funds have been widely exploited. Instead, most state legislatures have been engaged in a great deal of backing and filling. There has been much well-publicized debate on tax issues, but these debates have not resulted in significant action. And a plethora of study commissions have filed reports—which have been quickly forgotten.

At the local level, with a few exceptions, inaction in the tax field has



crease of taxation at the state and local level. But that increase does not look so large when it is compared with the increase in national output or income. State and local tax collections rose from \$13 billion in 1948 to \$35 billion in 1960; but this only represented a rise from about six to nine per cent of national income. Moreover, the ratio of these taxes to national income in 1948 was at a low level compared to the ratios in prewar years. In 1927 and again in 1934, for example, state and local tax collections represented nine per cent of national income—or the same percentage as in 1960.

IN RECENT YEARS, of course, a substantial array of new taxes has been levied in many states. Even New Jersey and Delaware, traditional havens of corporate privilege, have introduced corporate income taxes. Hard-pressed West Virginia recently enacted a personal income tax, thereby becoming the first state to do so since 1937. Some half of the states now impose both income and sales taxes. Nebraska remains the sole holdout against sales, personal or corporate income taxes.

There have, however, been few, if

been even more pronounced. One hears a great deal about the "crushing burden" of local property taxes and receipts from this source have, indeed, advanced from \$6 billion to \$16 billion since 1948. But they still represent a somewhat smaller fraction of total private income than they did in the prosperous years of the latter 1920s, when collections from this source were approximately \$5 billion per year.

Income taxes at a very low rate—typically one per cent—have been introduced by hundreds of localities in Pennsylvania, by most of Ohio's larger cities (the main exceptions being Akron and Cleveland), by a few cities in Kentucky and by a handful of cities elsewhere. There are local sales taxes in almost all of California and Illinois, in parts of New York State and in a few other scattered communities. But, by and large, the property tax remains the main source of local tax revenue. It still accounts for more than 85 per cent of total local tax receipts.

Thus, the burden of state and local taxes can hardly be said to be more "crushing" than in the past. Surely it is reasonable to assume that, as both personal and national

income increase, a rising proportion of the total national output becomes available for meeting our increasing needs for public services. From this one may deduce that we have, in fact, experienced a substantial decline in the relative burden of state and local taxes.

BEFORE we can evaluate the prospects for meeting the urgent needs in the public sector we must have some idea of the sums of money involved. "Needs" in this instance are very difficult to define. One sometimes gains the impression, for example, that some professional experts will not be satisfied until the landscape has been flattened and covered with concrete highways, or that educational "needs" constitute a veritable bottomless pit into which tax dollars may be poured without limit.

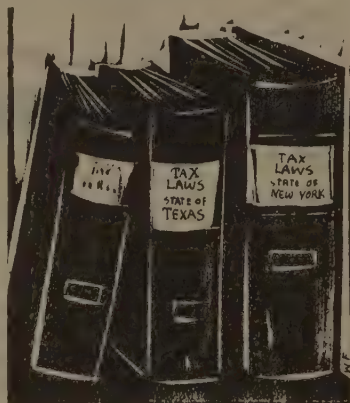
To the economist, however, there are no "absolute needs"; there are, instead, choices to be made among the thousands of alternative uses to which limited resources may be put. These choices involve selecting from among alternative uses in the public sector as well as choosing between spending in the private or in the public sector. Each state and community, governed by the preferences of its residents, must decide whether to have more private spending or more public spending, as well as how the public spending should be allocated among competing uses.

Unfortunately, we do not have the kind of guidepost in the public sector that is provided by the market in the private sector. Those responsible for public budgetary decisions can only exercise their best judgment as to the preferences of the electorate. And the electorate is not always sufficiently informed; nor is it always articulate. Decision-making is rendered even more difficult because what is done today will necessarily affect unborn generations. Therefore, we are faced with the problem of trying to decide what will be best for them, even though we do not know what their scale of values will be.

It is, therefore, impossible to arrive at a figure which reasonable men might agree represents the gap between existing or prospective revenues and the revenues required to

provide an "adequate" level of public services. As was indicated earlier, however, it seems clear that there is such a gap.

My personal guess is that the gap amounts to approximately \$15 billion per year, or about one-third to one-quarter of the present amount being spent annually by state and local governments. Is this sum one that may reasonably be said to be within our reach, given current levels of output and income in the economy? One way to look at this question is to recognize that \$15 billion represents about three per cent of gross national product. Or we might say that this figure represents only about one-third of the addition-



al output that would be forthcoming were we able to reduce unemployment from its mid-1961 rate of close to seven per cent of the labor force to three or four per cent, which is generally agreed upon as a desirable goal.

Expressed in these terms, \$15 billion in additional state and local revenues hardly appears to be an impossible objective. But there are formidable obstacles to its attainment.

IT MAY BE argued that the federal government has pre-empted the taxpayer's dollar to such an extent as to leave only poor pickings for the states and their local subdivisions. But when this argument is examined in the light of what has happened to aggregate income after deduction of federal taxes it appears to be rather less than convincing. Federal tax

receipts have doubled since 1948, but national income has almost doubled as well. And national income less federal taxes has increased by about \$150 billion.

Some observers are too easily misled by the high federal income tax rates, which run up to 91 per cent. If a rate as high as this ever, in fact, applied to a substantial portion of the income of even a few taxpayers, the argument might have some force. However, taking into account the untaxed part of capital gains, exempt interest on municipal bonds, overgenerous depletion allowances, the very broad extension of capital gains treatment to many kinds of income, and various other so-called "loopholes," the rate of tax paid does not exceed 40 per cent of income for even the highest income brackets.

Moreover, state and local taxes are deductible in figuring one's federal income tax. This means that the federal treasury absorbs—and, in effect, pays—a portion of state and local taxes. This proportion increases as the taxpayer's income goes up. For example, a federal tax rate of 90 per cent on income combined with a state income tax of 10 per cent does not add up to a total tax rate of 100 per cent; the total rate is either 90.1 or 91 per cent, depending upon whether or not the state permits, as many do, the deduction of the federal tax in computing state income tax.

Thus, the failure of state and local governments to raise sufficient tax revenues to meet their needs cannot be ascribed to federal pre-emption of available sources of tax money. Other obstacles do exist, however, and these can be extremely difficult to overcome.

IN CERTAIN STATES there is widespread agreement on the desirability of raising additional tax revenues, but bitter disagreement on what taxes to increase or institute. This is true of Massachusetts, Minnesota, Wisconsin, Michigan and Indiana among others. Typically, the battle lines are drawn between the proponents of income taxes and of sales taxes. To some considerable extent, it is a struggle between liberal and conservative factions, with organized labor generally on one

side and organized business groups on the other. The impasse is especially difficult to break when, as is often the case, the issue becomes a political football.

The continuing competition among states for industry is another factor which limits the ability of state and local governments to raise more revenue. Even some of our richest, most heavily industrialized states—including California, Massachusetts, Michigan and Pennsylvania—fear that even present levels of taxation will force business to move to other, lower-tax states. State income tax rates (which rarely go above 10 per cent and which are much lower when deductibility at the federal level is taken into account) are held responsible for the exodus of high-income families and for difficulties encountered by local businesses in attracting top-level personnel.

Such forces are, of course, accentuated at the local level, where governments are even more vulnerable because of the greater ease with which businesses and individuals may find tax havens without giving up the advantages offered by the larger region.

The undernourishment of public services, especially in the case of local governments, is partly because varying proportions of the benefits flowing from such services do not accrue to the local taxpayer. Perhaps the clearest example of this may be seen in the case of air pollution control.

Obviously, the citizens of any one area within a large metropolitan region cannot get more than a small proportion of the benefits to be derived from air pollution control. Under these circumstances, in the absence of cooperation throughout the region, a dollar of tax money cannot be spent efficiently from the point of view of any one jurisdiction. From the standpoint of the region as a whole, air pollution control cannot be supported at the level that would be warranted if taxpayers could weigh taxes paid against total benefits derived. The result, in this instance and many others, is that either the service is not provided at all or it is supplied inadequately.

Finally, outmoded constitutional and legislative restrictions prevent many of our states and thousands of

local units from levying taxes that would enjoy majority support.

CAN THE obstacles to adequate financing of public goods and services—whatever “adequate” may mean—be surmounted? Perhaps the solution with greatest appeal for most state and local governments is an increase in federal aid in one form or another. Proposals range from those which call for liberalizing and extending the existing program of grants-in-aid to allowing the taxpayer to deduct his state income tax from his federal tax liability rather than from his gross income, as is the case today.

All such proposals have their

SCRAPING THE BOTTOM OF THE BARREL?

BUSINESS LICENSE TAXES are a device often used by states to tap new sources of revenue. Here are a few examples of annual license fees levied on retailers in the past:

Alabama	coffins—to \$100
Colorado	psittacine birds—\$15
Iowa	baby chicks—\$10
Maine	deer heads—\$25
New Jersey	goat's milk—\$10
North Dakota	snuff—\$5
Oregon	garbage fed to swine—\$10
Wisconsin	fishing bait—\$25

faults, but there is much to be said for expanding the role of the federal government in financing the services which state and local governments provide. Federal aid may be employed effectively as a means of curbing self-defeating competition for industry between localities; it may be used to equalize tax burdens in relation to the benefits of public services enjoyed; and it may ensure the supply of services which involve benefits distributed over a wide area.

Federal aid may also be used as an incentive, as it is employed now, to encourage more generous provision of services in which there is an important element of national interest. Public health, highways and education are but three of the more obvious areas in which this could be done more effectively.

It is doubtful, however, that fed-

eral aid can or should be called upon to carry all the burden. There is certainly much room for action at the state level. In most states, the larger towns and cities are capable of administering taxes other than the property tax and should be afforded the opportunity to levy them. Or—and this is in many ways a more attractive proposition—the states could allow local governments and public bodies the option of imposing supplements to state taxes. In general, many states could profitably review and revise their state-local fiscal arrangements.

There would appear, too, to be ample opportunity for the extension of “user charges”—that is, the costs of a wider range of public services could be borne directly by those who use them. Also, in most jurisdictions the property tax could be made to yield substantially more revenue. But the adverse impact of property taxes on improvements; the burden that they impose on investment in housing, commerce and private industry; as well as other unattractive features of property taxes all argue against this approach.

In short, there do not appear to be major economic obstacles to be overcome in substantially increasing state tax receipts. The principal obstacles, as we have seen, are political. Additional sources of tax revenue could be found without great difficulty, if agreement could be reached as to which sources should be used first. In Michigan, for example, a very modest two per cent flat-rate individual and corporate income tax (levied on taxable income as defined in the federal law) would yield \$200 million per year. Competent observers believe this would provide more than enough to bring public services up to acceptable standards.

The liberals, for their part, are more concerned with obtaining better public services than with achieving equity in taxation at the state and local level. This is the approach that Galbraith urges in *The Affluent Society*, since, in general, the benefits flowing from public expenditures accrue to all members of a community, regardless of their income. In essence, public services, almost irrespective of how they are financed, will reduce inequality in the distribution of real income. ■

ARE THE FORECASTERS TOO OPTIMISTIC?

by WILLIAM C. FREUND

► In this dissent from the widespread predictions of an \$800 billion economy by 1970, the author takes issue with Dr. Gerhard Colm of the National Planning Association and other economic forecasters. DR. FREUND maintains that their assumptions concerning productivity increases are unrealistic. That increase, he predicts, will be around 2.5 per cent a year, not around 3.5 per cent, as assumed by the NPA.

The author served, until recently, as Assistant Director of Economic and Investment Research for the Prudential Insurance Co. He is now Associate Professor of Finance at New York University's Graduate School of Business Administration.

ALMOST a century ago, in August of 1867, Mr. J. N. Boyd, then editor of the *Fairmont Gazette* of West Virginia, tried to predict certain events 100 years in the future. Since the hundred-year period has almost expired, we can now judge the accuracy of his projections. Unlike some forecasters, I am sure Mr. Boyd will not mind our reviewing his predictions. Mr. Boyd wrote that:

- Every child will be in easy reach of a schoolhouse.
- Color of the skin and sex will not distinguish voters.
- Handsome and accomplished women will occupy seats in the legislature and state department.
- Trains will pass Fairmont, West Virginia 12 times each day.
- Letter postage will be one cent instead of three.
- The national debt will be paid.
- Women will propose marriage.
- There will be no Methodists, Presbyterians or Baptists—all will be one denomination.
- Women will eschew hoops, long

dressess, waterfalls, palpitations and other false and senseless things generally.

Unfortunately, Mr. Boyd's prognostications have turned out rather badly. Fairmont does not have a dozen railroad trains passing each day, and few women in the past 100 years have entirely eschewed all "false and senseless things."

Man always seeks to look ahead. Certainly this is among his most distinguishing characteristics. In the June issue of CHALLENGE, projections were presented by the economists of the National Planning Association of the probable growth of the economy during the Sixties. The authors concluded that our gross national product (GNP), will reach \$800 billion by 1970, measured in the purchasing power of today's dollars. This portends a rise of nearly \$300 billion, or 60 per cent in our nation's output of goods and services.

PROJECTIONS of an \$800 billion GNP by 1970 have become almost commonplace. The National Industrial Conference Board, *Fortune* magazine, and other public and private agencies have reached much the same conclusions as the National Planning Association.

Are these projections realistic? Are they reasonable estimates of where our economy is likely to be 10 years hence, or are they merely optimistic estimates of our maximum economic potential?

On one point all persons making projections of our nation's economic growth are agreed. It is impossible to forecast the cyclical fluctuations in GNP 10 years into the future. What the projections seek to show is not when recessions and prosperity will occur but the *trend* of the economy

which will form the background for the swings in business activity. The key issue therefore turns about the question of whether the *trend* of the value of GNP, apart from any price inflation, will increase to as much as \$800 billion by 1970.

The National Planning Association can point with pride to the accuracy of its projections 10 years ago. Thus, Gerhard Colm and Peter Wagner, respectively Chief Economist and Associate Economist of the NPA, point out in their CHALLENGE article that the NPA estimates for 1960, prepared back in 1952, came close to the mark. This study, they recall, estimated that total production of goods and services would increase from \$329.2 billion in 1951 to \$425.6 billion in 1960 (measured in 1951 prices). When expressed in 1960 prices, this gives a GNP of \$505.5 billion, compared with the actual figure of \$504.5 billion. Remarkable accuracy, indeed, even if we allow for the fact that 1960 was a year of recession when output was much below the long-term trend.

I have studied with some care numerous GNP projections prepared a decade ago. Most of them were rather accurate. Can we assume that the current crop of projections will meet with equal success?

All GNP projections depend in the final analysis on three very basic assumptions:

- The size of the employed labor force.
 - The average length of the workweek.
 - The rise in productivity—that is, in output per man-hour.
- The recent CHALLENGE article illustrates this procedure. For the decade of the Sixties, it assumes:
- an increase in the employed labor force of 20 per cent;
 - a decrease in the average workweek of 5 per cent;
 - and an increase in manhour production of 43 per cent;
 - giving an increase in GNP of 58 per cent.

Obviously, any disagreement with the National Planning Association's projection must be based on a difference of opinion regarding the outlook for at least one of these three

fundamental elements of economic growth.

EMPLOYMENT. The NPA projects the number of civilian employees 10 years hence at 81 million compared with 71.5 million today. This estimate is likely to prove fairly accurate. All members of the labor force 10 years hence are already living so that there is no need to debate whether our birth rate will be high or low.

One can argue, however, about the NPA assumption that unemployment will average only 3.5 per cent of our labor force.

Even in the best of times some people are always out of work. They may be between jobs, or undergoing retraining, or moving to another part of the country. In each month since April, 1957 unemployment has averaged over four per cent of the civilian labor force. Manifestly, some of the recent high rates of unemployment (near seven per cent) can be ascribed to the recession of 1959-60. But, in part, they have also been due to what official Washington has called "hard core" or "structural" unemployment.

This type of unemployment results from such innovations as the complete automation of assembly lines, the use of computers for clerical work and the mechanization of farms. It affects most strongly the unskilled and semiskilled, the young and inexperienced, the underprivileged and minority groups. It means that there are a large number of unemployed persons who cannot hope for better things even with economic recovery; it results in what Prof.

Clarence Long of Johns Hopkins recently called the problems of rising "prosperity unemployment."

I recognize, of course, that structural unemployment, though it often seems chronic, is not inevitable. If the displaced steelworker and the unemployed coal worker could be retrained and relocated, if our work force could somehow be made more responsive to the changing needs of employers, structural unemployment would be reduced. But in preparing our GNP projections we cannot ignore the possibility that unemployment will range higher than the 3.5 per cent assumed by the NPA and that GNP will be correspondingly less.

WORKWEEK. I agree with the NPA's assumption that the average workweek will decline by about one-half of one per cent per year, or five per cent over the decade. This projection is clearly in line with the trend during past decades.

PRODUCTIVITY. When it comes to the assumption about productivity, however, I part company with NPA.

Productivity is a measure of our efficiency, of the increasing output of goods and services produced by each man-hour of labor. Actually, to measure the efficiency of production, we should relate our output not only to the number of man-hours of labor invested in production, but also to the input of machinery, plant and managerial skill. For lack of better statistics, however, and for lack of any other common denominator, we usually define productivity as output per man-hour.

Of the three major elements in an economic projection, the assumption concerning productivity is the most crucial. Relatively small percentage differences in productivity easily become multiplied into tens of billions of GNP dollars. A one per cent change during a decade in either hours worked or size of the work force affects GNP by less than \$10 billion. But changing the assumption of productivity growth by only one-half to one per cent per year results in changing GNP by \$50 billion.

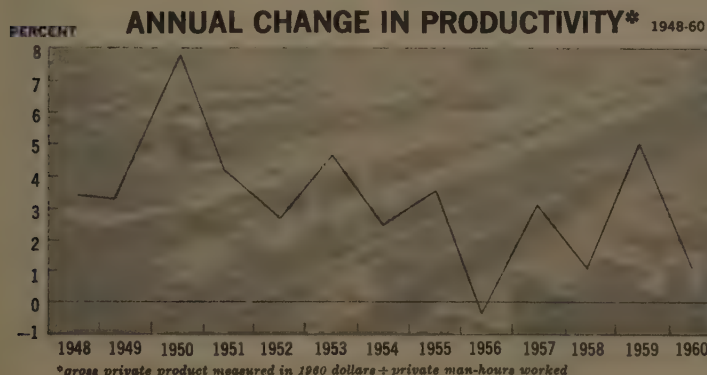
The NPA assumes that productivity in the Sixties will rise by 3.5 per cent per year, or more than 40 per cent when compounded over a 10-year period. It is this critical assumption to which I take exception. Had the NPA assumed a productivity rise of only 2.5 per cent a year, which, for reasons I will discuss later, appears more probable, the GNP figure for 1970 would look very different. Instead of an \$800 billion economy, our output of goods and services would total only \$700 billion. Instead of a rise in output of \$300 billion over 10 years, the rise would be only \$200 billion, or two-thirds as great.

If all these figures seem abstract or unreal, think of the lower output—\$700 billion per year—as meaning \$1,200 less for each employed worker. Whether we have a \$200 or a \$300 billion increase in national output during the approaching decade will affect not only our standard of living, and perhaps the rate of unemployment, but the whole complex of economic—and political—problems with which we must be prepared to deal.

In its 1952 projection, the NPA assumed a growth in productivity of only 2.5 per cent per annum. It was precisely because productivity actually rose at this rate during the Fifties that the NPA's projection for 1960 turned out so well. Back in 1952 the NPA justified its 2.5 per cent assumption by noting that:

- The average productivity gain since 1929 had been just over two per cent and
- during the Forties the gain had averaged just about 2.5 per cent.

WHY is the NPA assuming so great a rise in productivity for the Sixties when in the Fifties the increase was



only some 2.5 per cent? The reason is that since 1947 private productivity has actually increased by 3.2 per cent per year. Thus the NPA assumes that productivity will not only continue to rise at this rate but even accelerate.

A CLOSER examination of the facts, however, reveals that to take an average for the entire postwar period is misleading. Just glance at the chart on page 37 and you will see why productivity rose by only 2.5 per cent per year between 1950 and 1960 but by more than three per cent between 1948 and 1960. Due to a number of special circumstances, unlikely to recur in the coming decade, productivity spurted ahead in the early postwar years, especially in 1949 and 1950, at rates which we have been unable to sustain for any length of time.

These years were marked by an enormous pent-up demand for consumer goods—cars, refrigerators, washing machines—a demand which had gone unsatisfied during the long years of depression and war.

Thus, the early years of the postwar period were marked by a pressure of consumer demand which in-

conflict had something to do with lifting over-all demand and stimulating the rapid productivity rise during these years.

Surely, these are circumstances not comparable to those assumed by the NPA in its projection to 1970. No longer can we count on a shortage of automobiles, appliances, housing, steel, machinery and the like to spur capital investment. No longer can we count on a shortage of labor brought about by low birth rates 20 years before. On the contrary, we must be prepared to absorb an unprecedented growth in our labor force, especially of those aged 20 to 24. During the 1960s our labor force will grow by nearly 20 per cent, compared with less than 13 per cent during the Fifties.

This development will tend to deter inflationary wage settlements and in turn reduce the incentive of employers to substitute machinery for scarce labor. Finally, the increasing emphasis consumers are placing on the purchase of services, such as recreation and leisure time activities, where productivity increases are below average, will tend to slow down our over-all growth in output per man-hour.

barring an intensification of the cold war and a much larger defense effort than is now planned, productivity will neither boom as it did right after the war nor fall below the rate of recent years. If I had to cast my ballot for a specific GNP figure by 1970, I would vote for a \$700 billion GNP, expressed in 1960 dollars, resulting from a 2.5 per cent annual gain in output per man-hour.

My warning therefore is to guard against basing public policies on overly mechanical extrapolations of the three fundamental factors of economic growth—productivity, employment and hours worked. We have already closed the chapter on the postwar years of pent-up demand and labor shortages. Without a change in long-established trends, productivity is unlikely to exceed 2.5 per cent, even with our present dedication to research and development. Moreover, unemployment may well average higher than it has in the past unless we succeed in coping with the problem of structural unemployment.

The NPA's optimistic projection serves, however, one very useful purpose. Its \$800 billion projection defines the kind of economic growth we could attain if we deliberately and consciously shaped our national policies to that end. The NPA's report underscores the need to stimulate private investment through modifications in our tax laws, through the development of new products, through the search for new markets and, most important, through an improved system of education which encourages creativity rather than routine effort. We need to devote a great deal more of our ingenuity to devising specific proposals for stepping up our productivity if the NPA's projection of an \$800 billion economy in 1970 is to become a reality.

The need to stimulate gains in productivity is clear. The whole world is watching our economic performance. Nothing would suit Soviet propaganda better than to be able to dazzle the backward nations with the superior growth of their system. Only if we succeed in forging policies for substantially boosting our output per man-hour will the NPA's prognostications fare any better than Mr. Boyd's of a hundred years ago. ■



duced manufacturers to increase their productive efficiency to the utmost. Add to this the fact that manufacturers were just then getting delivery on new machinery and plants which previously could not be built. Also, bear in mind that during these years labor was in very short supply, especially young workers in their twenties and thirties; this brought pressure on producers to mechanize, to substitute machinery for labor, to step up productivity in every conceivable way. Finally, the Korean

What, then, is the prospect for the approaching decade? Is productivity likely to fall back to its long-run trend of just a shade over two per cent (to be exact, 2.1 per cent between 1900 and 1947)?

I do not think so. Our heavy commitment to research and development will contribute toward lifting our productive efficiency by 2.5 per cent per year, a rate more in line with our experience during the last 10 years than the previous half-century. What I am saying is that,

Canada at the Crossroads

by WILLIAM WOLMAN

► *With her postwar boom a memory and her economy in the doldrums, Canada's slow rate of growth has become a national concern. Although many of the country's problems are beyond her control, some action is essential. Is it to be along the lines of economic nationalism or along the path of closer economic cooperation between Canada and the United States?*

WILLIAM WOLMAN, who recently returned from a trip across the border, is a member of the economics staff of Business Week.

A MOUNTING MOOD of economic nationalism is becoming more and more a part of the Canadian scene. One of the continually recurring claims in the political in-fighting north of the border is that Canada's economic troubles stem from U.S. domination of her economy. And one of the most insistent cries in Canadian political life is for policies designed to bring this domination to an end.

These sentiments make it increasingly vital for the U.S. to take a more active interest in Canadian problems. Canada, after all, is one of our oldest allies and a partner in the North American Air Defense Agreements (NORAD)—our shield against a polar air assault by the Soviets. Moreover, our northern neighbor is our largest single trading partner. About 20 per cent of our total imports in 1960 came from Canada and 18 per cent of our total exports went to her. In addition, direct investment by U.S. business in Canada stood at \$10.8 billion at the end of 1960—about one-fourth of our direct private foreign investment.

During the early 1950s the Canadian economy was performing magnificently, with output growing at six per cent a year. That period

was the culmination of a quarter of a century of rapid economic growth. But since 1956 Canada's expansion has been far slower. Moreover, profit margins have been very narrow, unemployment has been a chronic problem and Canada has not been able to earn enough foreign exchange for real safety.

On top of all these troubles, Britain has dealt Canada a blow by opening negotiations for admission to the Common Market. Canada's economic health is dependent, to some degree, on exporting food and raw materials to Britain. True, Prime Minister Macmillan has assured Ottawa that Britain will not sacrifice Canada's interests in order to join the Common Market. But informed Canadians expect their country to lose some of the trade advantages she now has by virtue of preferential Commonwealth tariffs.

These difficulties, coming together, have impelled many Canadians to re-examine their economic policies. So far, the Conservative government of Prime Minister John G. Diefenbaker has resisted measures that might antagonize the U.S. A Supplementary Budget presented to Parliament last December did propose an increase in the rate of certain taxes on dividends transmitted abroad—a move which some commentators have described as anti-American. Actually, however, as Canada's Finance Minister, Donald M. Fleming, has pointed out, the proposed measures merely withdraw special privileges for *all* foreign investors: The Canadian government has made no other move which could be reasonably interpreted as anti-American.

The "Coyne affair" of last July, which culminated in the forced resignation of James E. Coyne, Governor of the Bank of Canada, was an

indication that the Ottawa government was opposed to a policy of economic nationalism. Indeed the country's economic problems have continued to be handled within the framework of traditional economic relations with the U.S., Britain and the rest of Western Europe.

But there is a strong feeling in many Canadian quarters that the government's policies to alleviate its problems—easy money, a massive deficit and a weakened Canadian dollar—were "too little and too late." This feeling makes it almost certain that the Prime Minister will call for an early general election—either this fall or next spring.

One of the important issues in the election will be that of Canadian economic policies *vis-à-vis* the United States. In an effort to capitalize on this issue, Canada's main opposition parties—the Liberals and the recently formed New Democratic Party—might propose limits on U.S. economic activity in Canada.

The New Democratic Party is a coalition of the old socialist party (the Co-operative Commonwealth Federation) and the 1.1 million member Canadian Labor Congress. This new political party is already on record as favoring return of the ownership and control of Canadian industry to Canadian hands. With the direct organizational and financial backing of the Canadian Labor Congress (the equivalent of the AFL-CIO) the New Democratic Party is certain to be a far more potent political force than was the CCF.

THE LIBERALS, hitherto the party favoring close economic ties with the U.S., could also take a nationalist tack. Lester B. Pearson, the leader of the Liberal Party, has already called for reconsideration of NORAD. And in a recent speech he asked: "Have we escaped from the colonial frying pan only to have jumped into the Washington fire?"

It could be that even the incumbent Conservatives will move toward nationalism in the coming political campaign; Prime Minister Diefenbaker may sense that this is what the electorate wants. He is a master politician—and quite capable of a rapid turnabout.

All this does not necessarily mean that Canada will seek to solve her

problems through a policy of economic nationalism. Though her citizens may have misgivings about the effects of U.S. domination of their nation's economy, they realize that there can be no question of "going it alone."

About 55 per cent of Canada's exports last year went to the United States and about 67 per cent of her imports came from America. Canada can hardly afford to alienate such a good customer. Moreover, Canadians are committed to the Western position in the contest with Russia and they know that the U.S. leads the West in that struggle—even though they may think that U.S. foreign policy in its economic as well as in its political aspects could sometimes be more wisely handled.

TO UNDERSTAND our neighbor's economic problems we should first examine Canada's postwar development.

Between the end of World War II and 1955 Canada went through a period of heavy economic growth. Real income, population and capital investment grew far faster than in the U.S.; indeed, Canada's growth rates were hardly paralleled anywhere in the world.

Behind this expansion lay the exploitation of the country's enormous wealth in raw materials. The rebuilding of the West European economies and the demand created by the U.S. postwar boom called for virtually all the raw materials Canada was able to provide. Foreign capital—chiefly from the U.S.—rushed in to take advantage of the strong world demand for raw materials.

As a result, massive raw materials extractive projects were created; among the most famous are those in Alberta (oil), at Ungava (iron ore) and at Blind River (uranium). Pushed along by such projects, total investment in Canada soared—exceeding 25 per cent of gross national product in some years.

This investment boom meant that the country had to open its gates to immigration to augment its labor force. Also, Canada's construction industry grew by leaps and bounds; it became far bigger, in proportion to the total work force, than that of the U.S. Many Canadians came to expect rapid growth to go on and on.



Prime Minister Diefenbaker

The boom collapsed in 1956—partly because of the slowdown in the U.S. and partly because of the growth of raw materials capacity in other parts of the world. The effect of this slowdown was to push down the Canadian growth rate from six per cent a year, the level attained between 1949 and 1956, to one per cent annually in the ensuing years. And because of Canada's rapid population increase, per capita real income was actually one per cent lower in 1960 than in 1956.

Canada now finds that there is little prospect for renewed raw materials growth in the Sixties at a rate comparable to that achieved during the immediate postwar years. In non-ferrous metals the world, outside of the Communist bloc, already has surplus capacity. Moreover, the U.S. protects much of its own mining industry with quotas. In aluminum the next phase of expansion is not likely to be in Canada; paper is no longer a Canadian and Scandinavian preserve; the world uranium boom has proved short-lived. However, iron ore exports are big and will continue to grow, and natural gas exports are likely to rise substantially.

CANADIAN economists now realize that the nation's next phase of expansion must come in secondary manufacturing. But in this area, too, the country faces formidable problems. Up to now, secondary manufacturing has been geared to a limited home market, partly because of tariffs protecting the U.S. market. It will not be easy for the relatively small Canadian manufacturing sector to expand sufficiently to compete on any significant scale with the U.S., Western Europe and Japan in world markets—particularly since

Canadian wage rates are relatively high.

Moreover, demography and geography make it difficult for Canadian manufacturers to expand their domestic markets greatly. Despite a population growth of 50 per cent in 15 years—from about 12 million in 1945 to about 18 million at the end of 1960—the Canadian home market is still too small to support plants large enough to bring costs of production to competitive levels in many lines, nor is it large enough to pay for adequate programs of industrial research.

Also, the Canadian people are spread over a wide area, thus making distribution costs high. A Canadian manufacturer typically must buy many more miles of transportation than a U.S. company to reach a given number of customers. Because of these problems, Canada has always depended on tariffs to protect her industry.

The country's difficulties with her secondary manufacturing industry, coupled with her need to increase exports, is the basis of Canadian economic nationalism—the desire on the part of her citizens to concentrate the ownership and control of Canadian industry to Canadian hands.

IN 1957, 60 per cent of Canadian manufacturing was owned or controlled by foreigners. In many key industries U.S. control is overwhelming: in 1960 U.S. companies owned 95 per cent of Canadian automobile capacity; 77 per cent of rubber capacity; 75 per cent of the oil industry; 60 per cent of electrical manufacturing; and 51 per cent of chemicals, and of mining and smelting. According to Canada's economic nationalists, this high degree of foreign control prevents Canada from developing a competitive manufacturing industry.

Here is how their argument runs: foreign companies have invested in enterprises in Canada either to provide raw materials for their home manufacturing industry or to serve Canada's domestic market. In either case, the foreigners' interests do not lie in the development of a fully integrated Canadian manufacturing industry that can effectively compete in world markets. Indeed, the accusation is frequently made that

U. S.-owned Canadian firms are not wholeheartedly interested in exporting from the Dominion.

Moreover, the argument continues, U.S. subsidiaries and branches in Canada have been at a disadvantage in competing with the foreign parent for export markets. For most research and development has been carried on in the labs of the parent companies. Thus technological advances have been largely dependent on the U.S.; and the newest methods and product lines were inevitably introduced too late for the most effective results. Moreover, U.S. researchers inevitably ignore the processes and products which might take the most effective advantage of Canada's resources and location. (The Canadian government's recent decision to allow tax credits on research may help this situation.)

A further complaint is that most of the top executives of U.S. subsidiaries in Canada are American citizens. Canadian plants are used by parent organizations as a seasoning ground for U.S. executives. As a result, the upward mobility of aspiring Canadians is limited. Furthermore, the corporate managers are most interested in the development of the parent organization. And the interests of the parent company may not always be consistent with the welfare of the Canadian economy.

Whether or not these grievances are valid, there is a strong argument for giving Canadian subsidiaries of



Opposition Leader Pearson

U.S. businesses a high degree of autonomy. Canadians have urged increasing the proportion of Canadians on the boards of directors of U.S. subsidiaries. They have urged that separate stock be issued for these companies so that Canadians may purchase equity shares in enterprises at present wholly owned by foreigners. And they have pointed out that executives developed in Canada should remain there throughout their careers, so that they may identify their interests with those of the nation's economy.

THE U.S. GOVERNMENT should urge rapid reforms to take care of these objections to the policies of American businesses in Canada. Such a program would be a sharp break with tradition for most U.S. companies, but it definitely would not lead to intolerable hardships. And it would eliminate one source of complaints against the U.S.

In my opinion, the answer to Canada's problems might well be some type of customs union between Canada and the U.S. Right now, however, the political situation in Canada makes it hard to imagine that such a union would appeal to a government bent on retaining political power. But surely the political problems are not more formidable than were those involved in moving toward an economic union between France and Germany. And if the U.S. were to present a plan designed to prevent further encroachments on Canadian economic self-determination, the proposal would have some chance of adoption in Ottawa.

Already there is discernible a drift of opinion in this direction. Recognizing that Canada's economic fu-

ture depends on the development of large-scale, specialized manufacturing industry which is internationally competitive, the distinguished Chairman of the British Columbia Power Commission, Hugh P. Keenleyside, recently proposed a "selective free trade" formula for Canadian and U.S. industry. And Neil McElroy, former Secretary of Defense and now Chairman of the Board of Procter & Gamble, was the first prominent American to discuss this idea publicly, which he did in a recent speech.

Under the selective free trade proposal, U.S. producers with Canadian plants would agree to split up their total product mix so that some items would be produced entirely in Canada and some in the U.S. As an example, General Motors might stop producing cars in Canada and perhaps stop producing some lines of trucks in the U.S. Tariffs on both items would be eliminated between the two countries.

Developments of this sort in important manufacturing industries would give Canada a chance to build large-scale manufacturing capacity. And although the effects on the efficiency of any given U.S. industry would be relatively minor, the addition of the Canadian market to that of the U.S. for a product could mean some economies of scale which hadn't existed previously for the American industry.

THE PROBLEMS of negotiating such a customs union might well be formidable. But through a proposal of this kind, the U.S. would be making a constructive move that might prevent a nationalistic reaction to Canada's economic difficulties.

Sometime during the next year, if the "inside" stories from Washington are correct, the Kennedy Administration will propose reciprocal tariff cuts between the U.S., Canada and the Common Market countries, thus charting a course toward what would be, in effect, a North Atlantic economic union.

One may hope that by the time this article is in print negotiations with Ottawa will have begun. For it is in the best interests of both Canada and the U.S. to work out a constructive solution to economic tensions. The days of "54-40 or fight" are gone forever. ■



The New Illiterates

by MORTIMER SMITH

► *The root of our educational system is diseased. A "new illiteracy" is spreading through the country. Already the results are showing up in college graduates who are indifferent to the precise use of language and ignorant of our cultural heritage. Such semieducated people will not be capable of providing the talent and leadership the nation will require in the critical years ahead.*

The remedy, according to MORTIMER SMITH, Executive Director of the Council for Basic Education, is to reform the elementary schools, beginning with the teaching of reading and grammar.

WHAT MUST the American educational system do now to insure national and individual welfare in the future? This is the urgent question people in all sections of our society are asking. The new interest in education on the part of the American public arises largely from a growing realization that too many of the contests—both ideological and material—between democracy and communism are being won by the wrong side.

It is difficult for Americans to realize that the United States is no longer the supreme military power. As Walter Lippmann said in one of his television interviews last summer: "Coming down from being supreme to only equal is an awful wrench for every country. People don't think it ought to be true; it's a hard thing to swallow."

If we are to improve our military position vis-à-vis the Soviet Union we must undoubtedly improve vastly the quality of our scientific education. Still, though Sputnik and the performances of Gagarin and Titov have shaken our confidence in the quality of our technology, there is reason for cautious optimism. Having been alerted to the seriousness of the problem, many private and gov-

ernmental agencies are doing excellent work in attempting to improve scientific education. In the fields of physics, chemistry, mathematics and biology much valuable experimentation is being carried on which will undoubtedly result in improved programs.

As far as science *qua* science is concerned we do not seem to be doing too badly. Despite a current drop-off in engineering enrollments, the National Science Foundation has recently predicted that the number of scientists and engineers with doctoral degrees can be expected, by 1970, to exceed 168,000—nearly twice the present number. But the question, perhaps, is not so much how many scientists—or lawyers or doctors or architects, for that matter—we will produce, but what kind of people they will be.

Will they be able to measure up to the conception of "the educated man" as that term was understood in the past? Will they have a sense of their common heritage and will they have that ability to adapt in the face of new situations which is the essence of intelligence?

THERE ARE disquieting indications that our educational system is not producing liberally educated men, but half-educated and lopsided men who may be specialists but who do not know how to communicate. There is ample reason to believe that there has been a vast decline in that literacy on which all sound and thorough education is based. I refer to literacy on two levels—knowledge of the letter itself (*litera*), and its extension in words and literature, and literacy in the sense of acquaintance with our common heritage of Western thought and culture.

Whatever the state of the world in the future, the basis of all education—and of all professional training—

will continue to be the word. And in America, despite the staggering tonnage of printed matter which is turned out annually, we suffer from a new kind of illiteracy. It is compounded of inaccuracy and indifference to nuances of meaning and produces imprecise thought. The source of this illiteracy, strangely enough, is the schools themselves. The new generation of teachers has been trained in methods not calculated to produce respect in their young charges for the subtlety, beauty and precision of language.

This brand of illiteracy is fostered from the time a child enters school by means of that gigantic guessing game which goes by the name of reading instruction. Under a system introduced in the 1920s, the child begins to learn to read without benefit of training in phonetics or knowledge of that infinitely convenient device, the alphabet.

Instead, he is taught "word recognition" through elaborate memorization of "clues" such as shape, length and height of letters—for instance, by remembering "the two eyes peeking out" in *moon* and "the tail of the y" in *monkey*. Under this system the child may see the word *snow* with an accompanying picture and guess that the word says *cold*—whereupon he will be congratulated by his teacher for coming close enough for all practical purposes.

Thus begins for many a habit of guessing, improvising or interpreting, rather than learning what the writer actually said—a habit deadly to precision of thought. It is amazing that so many actually learn to read under such a cumbersome system. It is understandable that many do not; James Bryant Conant says he has been in schools where as many as 30 per cent of the pupils in the ninth grade are reading at the fifth- or sixth-grade level. Other observers believe that Dr. Conant's estimate is low and that the situation is much worse than his figure suggests.

FAULTY reading instruction is only the first step along the road to illiteracy. It is quite likely that as the student grows older he will be assured by his teacher (who will be backed by professional bodies of teachers of English) that there is no one correct way of speaking and writ-

ing. He will be told that there are appropriate levels of usage depending on the occasion and whether one is speaking or writing. In other words, there is no "right" or "wrong" way, only an "appropriate" way.

If a child lives in Iowa his teachers will follow a handbook for English issued by the Department of Public Instruction. This work lists several examples of poor usage (he must do *like* you say, *who* do you want?, a great heap of books *are* on the table, etc.), and then goes on to state: "teaching corrections for these . . . is a waste of time and a source of confusion to the students. . . . Only in formal literary writing and in formal speech are finer distinctions made." No stuffiness here—and no doubt the teachers do *like* the Department of Public Instruction says.

CONFUSION is spread further by the growing conviction among teachers that grammar is a plot against youth thought up by joyless pedants—a conviction shared by the Commission on the English Curriculum of the National Council of Teachers of English. The Commission maintains that grammar should not be taught before the seventh grade and then should "be confined to establishing the fundamental concepts of subject and predicate only" and that "to some students it may not be taught at all."

In view of this kind of early training, it is small wonder that the average American student finds it difficult to use his native tongue effectively. In some American state universities almost 50 per cent of the entering freshmen fail the examination in basic English. Oliver La Farge, after teaching undergraduates in some of the Western colleges, wrote a few years ago in the *Atlantic Monthly* of the "contorted faces" of students as they put pen to paper. "They can't write. . . . They cannot spell, punctuation is quite beyond them, the mere formation of a written word troubles them."

But the serious, indeed the tragic, aspect of this situation is that the bright student, as well as the average student, is affected by the new illiteracy. Dean William C. Warren of the Columbia Law School has for many years been eloquent on this subject. He says that "few of our en-

tering students, however carefully selected, possess those skills [of writing and speaking grammatically and literately] to the extent needed for law study."

A few weeks ago, in the pages of the *Saturday Review*, Dean Thomas M. Cooley II of the School of Law at the University of Pittsburgh expressed similar complaints. He said there are men in the law school who have mastered legal information but "cannot put this learning into words on their examinations or in their term papers so that we who have supervised the very learning which they seek to express can understand what they are talking about."

Dean Jacques Barzun of Columbia, speaking of some of the highly selected graduate students in his university, says that he finds "about one in 10 who needs coaching in the elements of literacy—spelling, punctuation, sentence structure and diction. And these students cannot write because they cannot read." Note that these men are talking, not of run-of-the-mill students, but about bright students—those who might be expected to be the leaders of the nation in 1980.

Thus on one level of literacy—the

myths, poetry, history, geography, religion, art—all that makes up our common heritage of Western civilization. The historic function of our education has always been to connect man with man through common knowledge and a shared viewpoint. But today education has become so scattered that, as Robert Hutchins says: "Two men attending the same university may well find little in their college life to draw them together unless they happen to remember the score of last Saturday's football game."

No college teacher today can assume that the young men and women in his classroom will have a common educational background or that they will understand ordinary allusion. References to Sisyphus and Ulysses, Cato, Cicero and Augustus, Don Quixote, Magna Charta, the Missouri Compromise, or *On Conciliation with America* will be greeted with honest puzzlement.

Prof. James J. Lynch of the University of California, testifying before a legislative commission, said that there are California high schools where no poetry is ever read and whose students "have never even heard of Chaucer, Milton, Byron or



use and understanding of language—it will be seen that American education is doing less than justice to both the average and the talented student. In the case of the latter it is often producing the bright ignoramus, a man who knows a lot about an important subject but who cannot communicate because he hasn't learned how to use the tool of language.

LET us now consider literacy on the other level—the knowledge of stories,

Whitman." This statement could probably apply equally as well to any state in the Union. An unknown book to millions of young Americans is the Bible, despite the fact that it has profoundly affected Western thought and, in the King James version, has influenced the cadence of some of our greatest literature. Today we cannot even assume common knowledge of those hardy stand-bys, *Silas Marner* and *Ivanhoe*.

One of the advocates of the newer dispensation in English education

has written revealingly in *The High School Curriculum*, a popular text for prospective teachers. He explains that although "the tradition of presenting young people with the literary classics that 'all cultured people are supposed to know'" still survives among some English teachers, different kinds of objectives are being proposed. He goes on to say that we must not set up an "*a priori* judgment about the general worth of the study of Shakespeare, of Milton, or Washington Irving" and should be busy experimenting "with a wide body of materials" which will work "for individual students." One suggested item: John Tunis' *Go Team Go* which he tells us will have a far greater effect on teen-age boys and girls than *Hamlet*.

GRANTED that there has been a breakdown in literacy, what can our educational system do now to prepare for the years ahead? I would propose that we redirect our emphasis in educational reform and begin to take a sharp look at American elementary schools. While a hundred committees and commissions in recent years have been rearranging high school and college curricula, our elementary schools have remained practically unchanged since 1925. The teachers in these schools have been taught, as a prominent professor of education has put it, that the chief goal of education is "the development of physical health, mental and emotional stability, fine personality and effective citizenship."

While one may hope that these things will be the incidental outcomes of education, they do *not* constitute its chief goal. As long as our elementary schools adhere to this catch-all theory of education, our high schools and colleges will have to contend with the uneducated or half-educated student—the student in whom the love of learning was starved before he got to the sixth grade.

The first purpose of the lower school is to make the child literate—that is, to provide him with those symbols of word and number, and those sets of facts that are the necessary preliminaries to more sophisticated learning at higher levels.

As one who has made the study of schools and education his chief

concern for some years, I would have no hesitation in stating that we are producing a nation of poor readers. An overhauling of methods of reading instruction, then, would be my first step in reforming the elementary program.

I believe that it is essential to return to systematic phonics instruction in the teaching of reading. I believe it because I have seen it work in those schools which have had the courage to buck the current orthodoxy in reading instruction. (For a description of some successful current programs of phonics instruction, and for a graphic examination of the whole reading situation, I refer my readers to *Tomorrow's Illiterates*, edited by Charles Child Walcutt and recently published by Atlantic-Little, Brown.)

The second step I would take to reform primary education would involve the reintroduction, from the very beginning, of grammatical analysis of language and the abandonment of the present attitude of *laissez faire* in usage. At the same time, the child should be made to write, write, write. The very first task of the school is to provide the pupil with the tools of language, for without this equipment his educational growth will remain forever stunted.

Step number three would be to scrap the idea that you can directly "teach" democracy and good citizenship and other assorted virtues through amorphous "social studies." Instead an attempt should be made to give pupils an ordered sense of history and historical ideas, a sense of geographical place, and a knowledge of the best thought and vision of men in story, verse and essay. The elementary school must introduce young people to the civilization of which they are a part. If knowledge of that civilization does not begin on this level, the high school student, as Clifton Fadiman has said, will not know who he is, where he is, or how he got there.

THIS IDEA of the school as the place where our heritage is transmitted was once an accepted part of the theory of elementary education. In the early 1890s the Committee of Fifteen of the National Education Association suggested that elemen-

tary school children read, among other writers, Milton, Tennyson, Scott, Goldsmith, Swift, Addison, Emerson, Hawthorne, Franklin and Cooper, in addition to the Bible, the speeches of Brutus and Mark Antony and the soliloquies of Hamlet and Macbeth.

I would not necessarily recommend that elementary schools follow this precise literary menu today, but I do suggest they would benefit from a similar nutritious diet. (It is an indication of the great change in educational philosophy that this list of readings was suggested by a committee of the National Education Association—an organization which today is apt to recommend that the child's literary yearnings be satisfied by *Growing Up in the Family* and *Our Animal Friends*.)

Many educators will decry the reforms I am suggesting. They will say that such a curriculum is too intellectualized, that it does not allow for individual differences, that the non-verbal can't take it. In short, they will continue to insist that a large segment of American youth is incapable of sustained effort and is uneducable. This is possible, of course, but the burden of proof is on them. Recent research in the measurement of intelligence suggests that we have perhaps been too hasty in setting up a deterministic scale of intelligence and in freezing the individual in a particular notch.

The sacred dogma of "readiness," by which educators justify postponement of learning, is apt to involve a gross underestimation of both the eagerness and the ability of the very young to learn. The experiments of psychologist O. K. Moore at Yale University have proven that average children of two, three and four years can easily learn to read and write. Proper motivation and early systematic training, rather than postponement, can do much for both the average and the below-average pupil.

In any case, it would seem that if we are to survive as a strong nation, we should begin now to shape new ideals for education. If we are not to sink into a condition of intellectual mediocrity, and to have our place in the modern world usurped by more disciplined nations, we had better begin now to reform our system of basic education. ■



Agenda for Coexistence

by KENNETH E. BOULDING

► KENNETH E. BOULDING is Professor of Economics at the University of Michigan and author of a recent study on the economic aspects of arms control.

HENRY G. AUBREY's study, *Coexistence: Economic Challenge and Response*,* is a useful and important volume in its own right. It is also an expression of a significant element in American political and intellectual life. The National Planning Association is perhaps the closest parallel in the United States to the Fabian Society of London, though the comparison might be received with at least slight embarrassment in both quarters. The N.P.A. certainly does not think of itself as "socialist," in the way that the Fabians of the 1890s did. This, however, may be more a function of the longitude and the date, and of the emotional rather than of the intellectual content of the word. The N.P.A. is more respectable, less alienated from its society and closer to the Establishment than were the Fabians. This, however, may be merely the result of 70 years of Fabian influence.

The New Fabians—in part thanks to the Old Fabians—live in a very different world from their spiritual ancestors. But the spirit is the same; the belief in Reason, in Research, in painstaking inquiry, in the long slow victory of truth over error, if only truth be properly cared for, and in a genial, but nevertheless intense, sympathy for the poor and the down-trodden which is the richest fruit of

a long Christian and humane tradition.

Now, of course, the poor are no longer the slum dwellers of paleo-industrial society, but are rather the peasant billions of the tropical belt. The Enemy, too, has changed. It is no longer the fat capitalist, mouthing the pieties of Manchester, or the roughshod imperialist laying on, rather than taking on, the white man's burden. Rather, it is the insidious Communist, offering rapid development at a price, a price in terms of a totalitarian society, ruthless political suppression, and a bleak atheocratic religion. Though the enemy and the prey are different, however, the battle is much the same, and the call is to high thinking, increased dedication and renewed effort.

DR. AUBREY's book is a summary volume of a series of studies on the Economics of Competitive Coexistence which was begun in 1956 and has already produced seven important works on various areas of the world where the issues are hot. A brief summary statement by the N.P.A. special project committee, a distinguished list headed by Simon Kuznets, gives the book a stamp of authority.

The work proper opens with a chapter on the meaning of "competitive coexistence"—a term which is perhaps the American idiom for Khrushchev's "peaceful coexistence." This is interpreted mainly as the competition for the friendship and allegiance of the less developed countries between the Communist bloc (and especially, of course, the Soviet Union) on the one hand, and

the United States and its allies and sympathizers on the other. The argument is conceived within a fairly strict economic frame of reference, with political and military questions hovering in the background. There follows, therefore, a brief discussion of the nature of economic development, and then five chapters on the economic capabilities of the major competitors—the Communist bloc, Western Europe, the United States, Japan and the Free World in general, with especial emphasis on the problem of unity among so many diverse and disparate partners.

Four chapters follow on the instruments of competition, such as foreign investment, aid, trade and political strings. Then comes a summary chapter on the images of the competing systems in the minds of the people of the poor countries. Finally, there is a chapter, which is almost an epilogue, entitled "Competition—and Beyond?" Here the author, not too sanguinely, hopes for something beyond the present cold war and encourages the West to look for a "big idea."

IT IS HARD to summarize a book as condensed and rich in content as this one, but if a single "big idea" emerges, it is that the West should not merely jump to the Communist whip, but should develop an autonomous policy of its own. In Dr. Aubrey's words: "The good things we are for are apt to impress the world more than the bad things we are against." Consequently, there should be emphasis on putting our own house in order, especially in regard to the extreme fluctuations in the prices we pay for the exports of the poor countries. For a fall in price during a single year can cost a nation more than all the aid it receives.

Meanwhile the Soviet Union is emerging as a "buyer of last resort." Its monopolistic organization and chronic shortages enable it to jump into markets, such as Iceland's fish and Burma's rice, which the West temporarily vacates. This ability seems well adapted to winning friends and influencing people; on the other hand there are disappointments—Soviet cement bags harden in Burmese rain and uncement the friendship. However, no clear solution for the West emerges, short of

**Coexistence: Economic Challenge and Response*. Henry G. Aubrey, with the assistance of Joel Darmstadter. 323 pp. Washington, D.C.: National Planning Association. \$5.00.

the unacceptable one of totalitarian organization.

A reviewer, like a preacher, is constantly on the lookout for sin, and in the case of a work as soberly done and as carefully processed as this, the sins are most likely to be those of omission. While it seems unfair to complain of these, nevertheless, in a book which is likely to be highly influential on actual policy, the omissions make one nervous. One is reminded of the man who could jump nine feet out of a 10-foot hole.

I have an uneasy feeling that the respectable liberal thinking of the N.P.A. is just not quite enough, even though it is in the right direction, to push us over the watershed to salvation. In its economic framework, the emphasis is too much on mere aggregate growth and not enough on the structural qualities of the Great Change. Its economic framework, too, is but loosely attached to political, social and military dynamics; the economic abstraction can be as deluding as the military abstraction in which political and ideological systems dominate the scene.

These complaints, however, do not detract from the merits of the present work. They merely indicate that one would like to see the work continue, even on the strictly economic side, into a quantitative study of the consequences of dependence, colonialism and independence, and, on the political side, into a study of the dynamics of ideological conflict and interaction.

The Challenge of Abundance. Robert Theobald. 235 pp. New York: Clarkson N. Potter. \$4.50.

• Stimulating, lucid and forceful, this study of the economic and political challenges of today is well worth reading. The author starts from the evident fact that we, in the West, have been startlingly successful in raising production and income to high levels. He then examines our economic and political institutions to see whether they are satisfying the needs "for a meaningful life or a valid sense of community."

We are, he finds, hobbled by modes of thinking that were useful in the past but which abundance has made obsolete. Needs that we could meet are being neglected. "The community should not tolerate slums; the individual may not be able to do much about

them and may even profit from their continuance. . . . The whole community, acting through its government, must influence and control the evolution of the economy and society. In order to perform this task it must have access to adequate funds. Present methods will not be adequate to raise the required money; new policies will have to be developed."

Many of Theobald's conclusions and recommendations may appear radical or visionary to those imbued with the "conventional wisdom." He himself, however, admits that he is doing little more than suggesting the framework of solutions for problems—economic and political—that are harrying us. His range is wide—from the role of the corporation and the labor union to the cold war and the needs of the underdeveloped countries. His experience as an economist makes him qualified to cover such a wide field. He has worked for the Organization for European Economic Cooperation, and as a consultant for the American Management Association, the Foreign Policy Association and General Electric.

While recognizing the difficulties that existing political attitudes and outmoded beliefs present to rational plans for using the world's immense productive capacity, Theobald is hopeful for the future. We will, he believes, rise to the challenge of abundance and remake our institutions so that they will provide us with a better life.

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What Price Economic Growth? Edited by Klaus Knorr and William J. Baumol. 174 pp. Englewood Cliffs, N. J.: Prentice-Hall, Inc. Cloth, \$3.95; paper, \$1.95.

• This searching look at the problems connected with economic growth grew out of a pilot study conducted under the auspices of the Center for International Study of Princeton University. The importance of achieving a higher rate of economic growth has been generally recognized. But the editors deplore the fact that "there has been a remarkable paucity of concrete and detailed proposals for accomplishing this aim and little analysis of the social costs." This is the gap that Knorr and Baumol, along with the other Princeton faculty members contributing to the study, have sought to fill.

Thus, they have examined in detail the consequences of a theoretical plan designed to effect a substantial increase in economic growth without generating inflationary pressures and without necessitating direct government control or regulation of the economy. Their plan

involves the use of over-all fiscal measures in order to induce private enterprises to increase their contribution to economic expansion. Specifically, the inducements would involve a system of pecuniary incentive payments, made through a combined system of taxes and rebates, based on a firm's annual *value added*. In other words, a tax would be levied on a firm's value added each year and a rebate would be given in proportion to the company's rate of growth.

Though it sounds simple, the plan would, of course, require a complex administrative machinery in order to function smoothly. The authors describe this machinery fully and then explicitly examine its costs—in dollars and manpower. They also consider the possible dangers and undesirable side effects of the plan.

All in all, the book describes a new and carefully conceived program for stimulating the economy. While it is somewhat too technical for the lay reader, it certainly merits the attention of those interested in the practical as well as the theoretical aspects of economic growth.

Also of interest

Conceptional Foundations of Business.

Richard Eells and Clarence Walton. 533 pp. Homewood, Ill.: Richard D. Irwin, Inc. \$9.35.

Farm Policy for the Sixties; a Statement by the NPA Agriculture Committee and a Report by Lauren K. Soth. 26 pp. Washington, D. C.: National Planning Association. \$1.00. Paperback.

Full Employment, Inflation and Common Stock. Melvin L. Greenhut. 87 pp. Washington, D. C.: Public Affairs Press. \$3.25.

Grants, Loans and Local Currencies: their role in foreign aid. Robert E. Asher. 142 pp. Washington, D. C.: The Brookings Institution. \$1.50. Paperback.

International Migration and Economic Development. Thomas Brinley. 85 pp. New York: Columbia University Press. \$1.50. Paperback.

Methods for Improving World Transportation Accounts, Applied to 1950-1953. Herman F. Karreman. 121 pp. New York: National Bureau of Economic Research. \$1.50. Paperback.

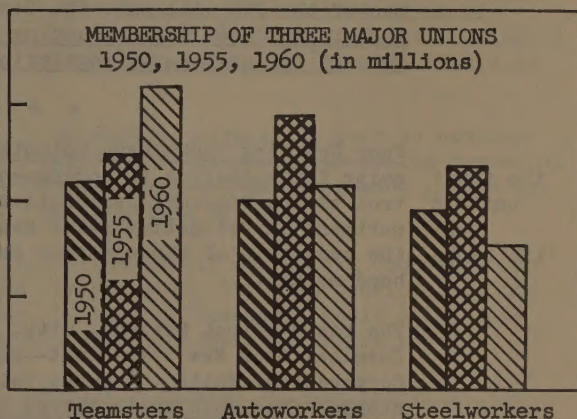
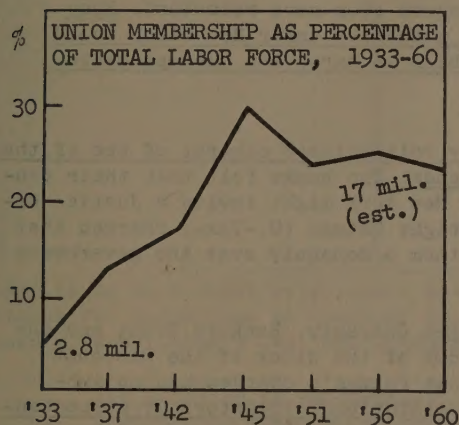
National Policy for Economic Welfare at Home and Abroad. Edited by Robert Lekachman. 366 pp. New York: Russell & Russell, Inc. \$7.50.

The Backward Society. Raymond Frost. 246 pp. New York: St. Martin's Press. \$5.00.



THE DOMESTIC ECONOMY—Although many recent Congressional investigations have aroused deep national concern over "corrupt and powerful" unions, the facts show that the labor movement, as a whole, has apparently reached an organizational plateau.

While labor union membership actually rose throughout most of the postwar era, it constantly declined as a percentage of the total civilian labor force. In 1933 there were 2.8 million union members—about 5% of the labor force. By 1945 membership had risen to 14.7 million and to about 30% of the labor force (see graph below left). According to reliable estimates, there are now about 17 million union members out of a labor force of more than 71 million—representing less than 24% of the labor force.



Because of new technology, the proportion of the labor force engaged in manufacturing and mining—the traditional strongholds of organized labor—has been declining. Conversely, between 1945 and 1960, the percentage of the labor force engaged in the service sector rose from 40% to 50%. This figure is bound to grow in the years ahead as the impact of automation continues to hit manufacturing.

This trend, however, has hit some unions much harder than others. Some, in fact, have continued to grow. The impact, for example, on the three largest unions—teamsters, autoworkers, steelworkers—in the decade from 1950 to 1960 (see graph above right) was quite different.

While the strength of the autoworkers remained about the same, the steelworkers lost almost 200,000 members and the teamsters gained about 500,000. Automation obviously had a much greater impact on a basic industry—steel—than on the men driving trucks. In addition, the teamsters under Hoffa have been much more aggressive in conducting organizing drives among workers other than truckdrivers.

What does this trend portend for the future of the American labor movement? It means that, while some unions will continue to exert a powerful influence because of their position in a key industry, the political power of organized labor is bound to decline as the unionized segment of the labor force continues to decline. In addition, the leadership of the labor movement will probably fall to those leaders whose unions are growing rather than to the heads of the traditionally giant unions in the mass production industries.

more power
for FTC? ECONOMIC NEWS NOTES—President Kennedy has urged Congress to give the Federal Trade Commission power to issue temporary restraining orders against alleged unfair practices while cases to obtain permanent orders are pending before the agency. These temporary orders could be appealed to the courts by the companies affected.

According to the Administration, the FTC's effectiveness has been severely hampered by its crowded dockets and its inability to issue restraining orders without extensive hearings. The Commission feels that it is detrimental to the public interest if a company is permitted to continue alleged unfair practices while the Commission is processing the case.

Getting such legislation through Congress would be difficult under any circumstances. The fact that Paul Rand Dixon, formerly counsel to Sen. Kefauver's Antitrust and Monopoly Subcommittee, is now the Chairman of the FTC will make the Congressmen even more reluctant. Many legislators feel that expanding FTC authority under Mr. Dixon would subject businessmen to regulation which is harsh and unsympathetic.

* * *

the trust
bustlers
vs.
the banks Four New York banks have voluntarily relinquished control of one of the major firms dealing in government bonds. The banks felt that their control of the Discount Corporation of New York might invite a Justice Department investigation after Rep. Wright Patman (D.-Tex.) charged that the ownership of these shares gave them a monopoly over the government bond market.

The banks—First National City, Morgan Guaranty, Bankers Trust and the Chemical Bank New York Trust—held 60% of the stock of the Discount Corporation. While the banks felt that Patman's charges had no substance, they sold their shares to institutional investors at a substantial profit and, at the same time, headed off a Justice Department inquiry.

The banking community has become increasingly apprehensive about its relations with the Justice Department since the Attorney General went to court last spring to halt proposed bank mergers in Philadelphia and Lexington, Ky. The trust bustlers' recent action to halt a merger of the Manufacturers and Hanover banks in New York—after it was approved by the Federal Reserve Board—has only served to increase the apprehension.

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account
numbers for
taxpayers Congress is almost certain to approve Internal Revenue Commissioner Caplan's plan to assign each taxpayer an account number. In sharp contrast to the other features of the President's tax "reform" proposals, there is practically no opposition to this measure.

Under the plan, a taxpayer's account number would be the same as his Social Security number. New account numbers would be assigned to the small minority who do not come under the Social Security System.

The account numbers are an important step in the government's program to introduce more automation into the tax-collecting apparatus. Automatic data processing machines will do a far less expensive and much more accurate job in detecting tax evaders than is possible under the present system.